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MEMORANDUM OF LAW

DATE: February 2, 1998

TO: The City's Defined Contribution Plans Trustee Board

FROM: City Attorney

SUBJECT: Applicability of the California Pension Protection Act to the City's Defined Contribution Plans Trustee Board and the City Council's Authority over the Board's Hiring of an Investment Consultant

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EXECUTIVE SUMMARY

The City of San Diego established and administers a number of tax qualified defined contribution retirement savings plans for its officers and employees, including three Supplemental Pension Savings Plans (SPSP) and a 401(k) Plan (the Plans). In 1996, the City and the Plans' participants created a board of five co-trustees to invest and manage the Plans and the Trust Fund assets. The Board of Trustees (Board) of the City's Defined Contribution Plans, has raised several questions about its authority and responsibilities, as contrasted with those of the City, in administering the Plans, the Master Trust Fund, and the Master Trust Fund Agreement (Agreement).

In particular, the Board asked whether the California Pension Protection Act (Act), which amended article XVI, section 17 of the California Constitution, is applicable to the Board. The Act, commonly known as Proposition 162, significantly affected the roles of public agencies and their elected or appointed retirement boards by granting the boards sole and exclusive authority and fiduciary responsibility over not only the investment of the pension funds, but also the management of the retirement system. The Board also asked whether it has the authority to unilaterally amend the Master Trust Agreement and the Plan Documents, and whether it must obtain City approval and follow City Council Policies when it contracts for investment consultant services.

There is a delicate balance of power and responsibility between the City and the Board with regard to the management and investment of the Plans and the Plans' assets. The rights and responsibilities of the Board are contained in the Plans, the Agreement, and state and federal trustee law. The autonomy granted to the Board by the City in the Plans and the Master Trust Agreement is consistent with the power allocation contemplated by the voters when they approved the Act.

The Act very likely applies to the Board because the measure includes all public pension or retirement boards. While the Act is silent concerning whether it should be applied to pension or retirement boards that manage defined contribution plans such as the City's 401(k) and SPSP Plans, it does contain a provision that states the Act shall be "liberally interpreted" to effect its purposes. One of the stated purposes is to "give the sole and exclusive power over the management and investment of public pension funds to the retirement boards elected or appointed for that purpose, to strictly limit the Legislature's power over such funds, and to prohibit the Governor or any executive or legislative body of any political subdivision of this state from tampering with public pension funds." California Pension Protection Act § 3(e). The measure also explicitly states that the People enacted the Act to provide special protection to public employees who sometimes must rely exclusively on their public retirement system benefits for

financial security in lieu of participation in the federal Social Security System. To protect these public pension rights, the boards that govern these retirement systems were granted autonomy from "political meddling and intimidation." California Pension Protection Act § 2(f). In the analysis and arguments contained in the official ballot pamphlet and materials, there is no indication that the voters intended to exclude public defined contribution retirement plans from the Act's provisions. Therefore, applying this Act to defined contribution plans would further the main purposes of the Act.

Also, the City's Defined Contribution Plans would very likely be considered "public retirement and pension systems" under the Act. The Plans fit the ordinary definition of a "public retirement and pension system." The City established the SPSP Plans as qualified money-purchase pension plans in lieu of participating in the federal Social Security System. Both of these Plans also satisfy the federal Social Security Act's definition of a "retirement system." Moreover, California Government Code section 53609 explicitly states that retirement plans that contain deferred compensation funds, as the SPSP and 401(k) Plans do, are included within the public retirement system provisions of the California Constitution section that the Act amended. Thus, it is very likely that courts would find that the Act's provisions applied to the Board.

Even if the Act did not apply to the Board, the City has already delegated its authority to the Board to not only administer the Master Trust Fund assets but also to administer the Plans. In the Master Trust Agreement, the City explicitly applied some of the Act's fiduciary investment standards to the Board. The City and the Plans' Participants authorized the Board to contract with American Express Trust Company to assume responsibility for administration of the Plans, under the direction of a Plan Administrator appointed by the Board. Therefore, as would be required under the Act, the Trustee Board has been delegated sole and exclusive authority to manage and invest the Plans and the Master Trust Fund assets.

The conclusion that the Act likely applies to the Board does not require any significant changes in the authority of the Board. However, applying the Act's provisions to the Board will impose stricter exclusive fiduciary responsibilities on the Board than are currently understood to apply. In particular, the Board will have the exclusive duty to ensure the competency of the Plans' assets to satisfy the Plans' liabilities. Further, the Board will be subject to the additional constitutional duties to incur only reasonable administrative costs and to minimize the City's contributions to the Plans. The City is not permitted discretion to veto the fiduciary administrative decisions of the Board regarding required administrative expenditures for the management and investment of the Plans and the Trust Fund assets. If the expense is not budgeted or approved by the City in advance, however, the City may not be obligated by the Board to pay the administrative expense. This procedure does not unconstitutionally infringe on the Board's authority, as the Board is authorized to use the Trust Fund assets to pay reasonably necessary administrative costs.

The Board is not required to obtain the City's approval before contracting with an investment consultant who will provide services related to the Board's management and investment of the Plans and the Trust Fund assets. Such a requirement would unconstitutionally usurp the power exclusively vested with the Board to perform these duties. Further, the Board is not required to comply with City Council Policies and Administrative Regulations with regard to the selection and hiring process used to retain a consultant whose services relate to areas within the exclusive jurisdiction of the Board. However, if the subject matter of the consultant's services relates to areas within the City's exclusive jurisdiction, the Board will be required to obtain the City's authorization to hire the consultant and will also be required to comply with the City Council Policies in contracting with the consultant.

Finally, the Board does not have authority to amend the Master Trust Agreement or the Plan Documents. As the employer and settlor of the Plans' Trust fund, the City has retained these exclusive rights. However, the City cannot make an amendment to the Agreement that affects the Trustees' rights and duties without the written approval of at least four of the Trustees. Agreement §§ 9.1, 9.2. Further, any amendment to the SPSP and SPSP-M Plans (other than a change that is required to maintain these plans' tax qualified status) must also be approved by the SPSP and SPSP-M Plan Participants. SPSP Plans § 11.01; 401(k) Plan § 9.01. The applicability of the Act to the Board does not provide the Board with the additional authority to amend these documents which establish the Board's duties and responsibilities and the level of benefits to be provided under the Plans. It is within the City's discretion whether to adopt any proposed Plan or Agreement amendments that are recommended by the Board. Within this balance of responsibilities and powers between the Board and the City, the City defines the level of the Plans' benefits, while the Board invests and administers the Plans and the Trust Fund assets.

QUESTIONS PRESENTED

The Board of Trustees (Board) of the City of San Diego's Defined Contribution Plans, has raised several questions about the authority and responsibilities of the Board, as contrasted with those of the City, in administering the Defined Contribution Plans, the Master Trust Fund, and the Master Trust Fund Agreement (Agreement). In particular, the Board has raised the following questions:

1. Is the California Pension Protection Act (the Act), which amended article XVI, section 17 of the California Constitution, applicable to the Board?

2. Does the Board have authority to unilaterally amend the Master Trust Agreement?

3. Does the Board have authority to unilaterally amend the Defined Contribution Plans Documents?

4. Must the Board obtain City approval to contract for investment consultant services related to management of the Master Trust Fund?

5. Must the Board comply with City Council Policies and Administrative Regulations when contracting for an investment consultant related to management of the Master Trust Fund?

6. When contracting for an investment consultant, must the Board require the consultant to comply with the requirements of the Federal Drug-Free Workplace Act?

SHORT ANSWERS

1. The Act very likely applies to the Board because the measure includes all public pension or retirement boards. The Act is silent concerning whether it should be applied to pension or retirement boards which manage defined contribution plans such as the City's 401(k) Plan and the Supplemental Pension and Savings Plans (SPSP), but it contains a provision that states the Act shall be "liberally interpreted" to effect its purposes. One of the stated purposes is to "give the sole and exclusive power over the management and investment of public pension funds to the retirement boards elected or appointed for that purpose, to strictly limit the Legislature's power over such funds, and to prohibit the Governor or any executive or legislative body of any political subdivision of this state from

tampering with public pension funds." Applying this Act to defined contribution plans would further these main purposes of the Act.

Even if the Act did not apply to the Board, the City has already delegated its authority to the Board not only to administer the Master Trust Fund assets but also to administer the participating Defined Contribution Plans. The Plans' Participants and the Board have approved a third party administrator to assume responsibility for administration of the Plans, under the direction of a Plan Administrator appointed by the Board. Therefore, as would be required under the Act, the Trustee Board has been delegated sole and exclusive authority to manage and invest the Plans and the Master Trust Fund assets.

2. The Board does not have authority to unilaterally amend the Master Trust Agreement. The Agreement specifies that the City, as the settlor of the Trust, retains the exclusive authority to amend or terminate the Master Trust Agreement. However, the City cannot make an amendment to the Agreement that affects the Trustees' rights and duties without the written approval of at least four of the Trustees. Agreement §§ 9.1, 9.2.

3. The Board does not have unilateral authority to amend the SPSP or 401(k) Plan Documents. The Plan Documents specify that the City retains exclusive authority to amend the Plans. Further, any amendment to the SPSP and SPSP-M Plans that is not required to maintain their tax qualified status must also be approved by the SPSP and SPSP-M Plan Participants. SPSP Plans § 11.01; 401(k) Plan § 9.01.

4. The Board is not required to obtain City approval before contracting with an investment consultant whose services relate to the Board's management and investment of the Plans' Trust Fund assets. Such a requirement would usurp the power exclusively vested with the Board to administer and invest the Master Trust Funds. However, if the nature of the consulting services desired relates to aspects of the Plan or Fund administration within the City's authority, the Board may be required to obtain the City's approval to contract with that consultant.

5. The Board is not required to comply with the City Council Policies and Administrative Regulations when contracting for an investment consultant whose services relate to the management and investment of the Master Trust Fund. Such a requirement would impermissibly infringe on the exclusive authority vested in the Board to perform these functions. The exception occurs if the subject matter of the consultant's services relates to areas within the City's authority. In that case,

the Board is required to follow City Council Policies and Administrative Regulations with respect to the selection process used to retain that consultant.

6. The Board is not required to incorporate the Federal Drug-Free Workplace Act certification requirements into the selection and hiring of an investment consultant. These requirements only pertain to parties who directly obtain grants or contracts from a federal agency. 41 U.S.C. §§ 701-706. Unlike the City, the Board is not a federal grantee or contractor. Further, when the services sought from the investment consultant are within an area in which the Board has exclusive authority, the City is not a necessary party to the investment consultant contract. Therefore, the Board is not legally required to compel a consultant performing these types of services to comply with the requirements of the Federal Drug-Free Workplace Act.

   Again, however, if the nature of the consulting services relates to an area under the City's authority, the City would be a necessary party to the consultant contract, and City Council Policies and Administrative Regulations regarding compliance with the Federal Drug-Free Workplace Act must be followed.

BACKGROUND

The City of San Diego established and administers a number of tax qualified defined contribution retirement savings plans for its officers and employees, including three Supplemental Pension Savings Plans (SPSP) and a 401(k) Plan (collectively, the Plans).[1] In 1996, The City and the Plans' Participants created a board of five co-trustees to invest and manage the Plans and the trust fund assets. An understanding of these Plans and their history is necessary to analyze the dynamic allocation of power and responsibility between the Board and the City Council.

I. THE CITY'S DEFINED CONTRIBUTION PLANS

[1] "Defined contribution plan" means "a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." 26 U.S.C. § 414(i). A "defined benefit plan" by contrast, is "any plan which is not a defined contribution plan." 26 U.S.C. § 414(j).

A. The Initial SPSP Plan

In 1982, the City Council authorized the City Manager to establish the initial SPSP Plan, pursuant to the City's withdrawal from the federal Social Security System. Participation in the Social Security System is not mandatory for public employees who are required to be members of a qualified public employee retirement system. 42 U.S.C. § 410(a)(7); 26 U.S.C. § 3121(b)(7)(F).

The SPSP Plan is a tax qualified money-purchase pension plan with a savings component. The fixed employer contributions, and the earnings thereon, form the basis for the money-purchase pension plan. The employee contributions, and the earnings thereon, form the basis for the savings component. On July 14, 1986, the IRS granted a favorable determination of the SPSP Plan's tax qualified status as a money-purchase pension plan pursuant to 26 U.S.C. § 401(a).

Under the Plan, City employees make mandatory contributions from their compensation. Employees may also make voluntary contributions to the Plan from their post-tax compensation. The City contributes an amount which equals 100 percent of the employees' mandatory and voluntary contributions. SPSP Plan § 3.01. However, employees do not become 100 percent vested in the employer contributions until the employees have earned five years of vested service credit. SPSP Plan § 8.02. For each year of service credit, employees vest 20 percent in their matching employer contributions to the Plan. SPSP Plan § 8.02(c). Employees do not pay tax on these employer contributions until they are distributed from the Plan.

The SPSP Plan is not required by federal law to comply with the defined contribution plan requirements of the Employee Retirement Income Security Act of 1974 (ERISA) or the Retirement Equity Act of 1984 (REA).[2] However, the City Council amended the Plan to voluntarily comply with certain provisions of ERISA and REA. In response to the confusion that was created in incorporating ERISA and REA provisions into the SPSP Plan, the City Council amended section 1.22 of the SPSP Plan in 1995 to state in part, "The Plan is a Governmental Plan within the meaning of Code section 414(d) and thus is not governed by the Employee Retirement Income Security Act of 1974 ('ERISA')."

B. 401(k) Plan

[2] See, City Att'y MOL No. 95-83 (October 11, 1995); City Att'y MOL No. 93-86 (September 24, 1993); 1986 City Att'y MOL 133; 1985 City Att'y MOL 368.

As a result of labor negotiations with the City's four labor unions, the City Council later established the 401(k) Plan as an additional benefit option plan, effective July 1, 1985. The 1986 Salary Ordinance states that the 401(k) Plan was established to provide a tax efficient method of retirement saving for its employees with pre-tax employee contributions, as described in San Diego Resolution No. R-263371 (June 10, 1985). State and local governments are now prohibited from establishing and maintaining a qualified 401(k) plan, pursuant to the Tax Reform Act of 1986, unless the plan was adopted before May 6, 1986. 26 U.S.C. § 401(k)(4)(B).

The 401(k) Plan is a profit-sharing plan which allows eligible employees to elect to make contributions to this Plan from their pre-tax earnings through payroll deductions and/or transfers from their Flexible Benefit Plan. These contributions are paid into a trust and are not included in the employees' gross income until they are distributed from the trust to the employees or their beneficiaries. The dollar amounts of employees' deferral contributions to the Plan are restricted by the safe harbor maximum deferral percentages established in the 401(k) Plan Document. Participants' combined contributions to this Plan and the City's Deferred Compensation Plan may not exceed the indexed dollar limits established by 26 U.S.C. §§ 402(g), 457. 401(k) Plan § 3.01. The City does not make any matching contributions. Also, unlike under the SPSP Plan, the City Council may terminate or amend the 401(k) Plan in whole or part without the approval of the 401(k) participants. 401(k) Plan §§ 9.01, 10.01. Any amendment that increases the duties and responsibilities of the Board, however, requires the Board's written consent. 401(k) Plan § 9.01.

C. <u>SPSP-M Plan</u>

The SPSP Medicare Plan (SPSP-M) was established by the City Council effective July 1, 1986. It was established pursuant to the federal mandate, 26 U.S.C. § 3121(u), for a Social Security Medicare hospital insurance tax for all government employees not covered by Social Security that are hired or rehired on or after April 1, 1986. San Diego Ordinance No. O-16649 (May 27, 1986); SPSP-M Plan Introduction. Even if an employee who is hired after April 1, 1986, is covered by a retirement plan such as the San Diego City Employees' Retirement System (SDCERS) or the City's Deferred Compensation Plan, the employee would also have to be covered for the medicare portion of the Federal Social Security System or by an alternative retirement plan with minimum contribution and benefit levels. All eligible non-safety employees who were hired or rehired on or after April 1, 1986, are members of the SPSP-M Plan.

The SPSP-M Plan is almost identical to the SPSP Plan except the employee mandatory and voluntary contribution rates are different. As with the SPSP Plan, the City matches 100 percent of the employee's mandatory and voluntary contributions. Employees do not vest 100 percent in the matching employer contributions until they have completed five (5) years of service. For each full year of service, employees vest an additional 20 percent in the employer contributions portion of their account. Like the SPSP Plan, the SPSP-M Plan cannot be

terminated or amended without approval of a simple majority of the Plan's Participants, unless the Plan amendment is necessary to maintain the tax-qualified status of the Plan. SPSP-M Plan § 11.01.

D. SPSP-H Plan

The most recently established defined contribution benefit plan was the SPSP Hourly Plan (SPSP-H) which was established by the City Council effective July 1, 1991, in response to the requirements of the Omnibus Budget Reconciliation Act of 1990. San Diego Resolution No. R-278180 (June 24, 1991). The Act requires all state and local government employees to be covered under a retirement system in lieu of coverage under the Federal Social Security System, including part-time, seasonal or temporary employees. This Plan is intended to provide all eligible hourly employees and Police Recruits, who are not eligible to participate in the SDCERS Plan, with supplemental pension benefits. Employees make mandatory post-tax contributions from their compensation. SPSP-H Plan § 3.01. The City makes matching contributions equal to 100 percent of the employees' contributions. SPSP-H Plan § 3.02. The Plan's Participants are 100 percent vested in the employer's matching contributions. SPSP-H Plan § 8.02. As with the other two SPSP Plans, the employer's matching contributions are not taxable to employees until they are distributed from the Plan. Unlike the SPSP and SPSP-M Plan, the City Council may amend or terminate the SPSP-H Plan in part or whole at any time without approval of the SPSP-H Plan Participants. SPSP-H §§ 11.01, 12.01.

II. CREATION OF THE DEFINED CONTRIBUTION PLANS TRUSTEE BOARD

In 1995 and 1996, the City Council approved amendments to the 401(k) and SPSP Plans which led to the creation of the Trustee Board (composed of appointed and elected Co-trustees), the establishment of the Defined Contribution Plans Master Trust Agreement, and the third-party administration of the Plans by American Express Trust Company. On March 20, 1995, the City Council passed Resolution No. R-285505 to make several amendments to the four Plans. One of the amendments created three appointed co-trustees to manage the Plans' trust funds, to include the City Treasurer, the City Manager, and the Retirement Administrator, or their designees. SPSP Plans § 13.01; 401(k) Plan § 11.01. Under amended section 5.02 of the SPSP Plans, the SPSP Plans' Administrator is responsible to establish and maintain a Trust Fund for the Plans' assets, which is to be managed by the co-trustees. Other amendments were designed to remove any plan limitations that would preclude the co-trustees from contracting for third-party administration and investment services for the trust funds which would then allow participant directed investment of the funds.

Before these amendments, all four of the Plans Documents provided that the City would select a sole trustee to hold and invest the Plans' trust funds and that the City Treasurer would

serve as the appointed trustee for these funds, if qualified. But the City, as the employer, reserved the right to change the trustee to another trustee under the trust agreement or other contract or to terminate the trust and hold the Plans' assets in another acceptable method. SPSP Plans § 13.01; 401(k) Plan § 11.01.

On March 18, 1996, pursuant to labor negotiation agreements, the City Council passed Resolution No. R-287054 to further amend the 401(k) and SPSP Plans by creating two additional participant elected co-trustee positions. One of the additional co-trustees was to be elected by the active 401(k) Plan Participants and the other co-trustee from the active SPSP, SPSP-M, and SPSP-H Plan Participants. The Resolution also amended the Plans to establish a loan program for the Plans' Participants to be administered by the third-party administrator. These portions of the 1995 and 1996 amendments to the SPSP Plans did not become effective until they were also approved by a simple majority vote of all the active Plans' Participants on July 10, 1996. SPSP Plans § 11.01.

American Express Trust Company (American Express) was selected to become the third-party administrator, investment manager, and custodian of the Plans' Master Trust Funds. However, American Express would not assume its duties or take control of the funds until a formal trust agreement was executed to create a master trust fund of all the Plans' assets and there were individuals in place who could assume their specified trustee duties.

III. CREATION OF THE MASTER TRUST AGREEMENT

On August 23, 1996, the City and the three City-appointed individuals currently serving as the Defined Contribution Plans Trustee Board, entered into a Master Trust Agreement (Agreement) which created a master trust to hold the 401(k) and SPSP Plans' assets. Under the Agreement, the following five co-Trustees are designated as the Trustee Board of the Defined Contribution Plans Master Trust: (1) the City Treasurer; (2) the City's Risk Management Department Director; (3) the Retirement System Administrator; (4) a participant elected member of the City's 401(k) Plan; and (5) a participant elected member of the City's SPSP Plans. Agreement § 1.1(h).[3]

Due to the need to have the third party administrator take over investment of the Trust Funds within the time line negotiated with the City's employees, the City did not wait for the two plan participant elected co-trustees to be elected before executing the Master Trust Agreement. A run-off election of the active SPSP and 401(k) Plan Participants had to be held the next month

[3] The Board co-trustees named under the Agreement are the same as those named in the SPSP and 401(k) Plan Documents except that the City Manager/designee co-trustee specified in the Plans is designated as the City's Risk Management Department Director in the Agreement.

from September 6 through 20, 1996. On September 23, 1996, a month after the Agreement was executed, the run-off election results were tallied and the two individuals who were elected to serve as the participant co-trustees were named.

The Agreement was properly executed and is a legally binding document notwithstanding the fact that the two participant elected trustees did not execute the Agreement at its inception because they had not yet been elected. When the Deputy City Manager signed the Agreement on behalf of the City, the settlor of the Master Trust, the Master Trust was legally created. The City Council delegated the authority to the City Manager to establish the Defined Contribution Plans. San Diego Resolutions Nos. R-255609 (January 4, 1982), R-263371 (June 10, 1985), R-278180 (June 24, 1991); San Diego Ordinance No. O-16649 (May 27, 1986). The SPSP and 401(k) Plan Documents authorize the Plan Administrator to establish and maintain a trust for the investment of the Plans' assets. SPSP and 401(k) Plans § 5.02.

The requirements for a valid express trust under California Trust Law include: (1) a settlor who has the capacity to transfer the property and who properly manifests the intention to create a trust (Cal. Prob. Code § 15201); (2) a trust property (Cal. Prob. Code § 15202); (3) a beneficiary (Cal. Prob. Code § 15205); (4) a purpose for the trust that is not illegal or against public policy (Cal. Prob. Code §§ 15203, 15204); (5) a legal term for the duration of the trust (Cal. Civil Code § 724(b); (6) a conveyance of the trust property to the trust; and (7) a specification of the trustee's duties. 60 Cal. Jur. 3d (Rev.), Trusts §§ 13-16 (1994). These requirements were met once the City executed the Master Trust Agreement. Further, a trust can be created without notice to or acceptance by the trustees. Restatement (Third) of Trusts §§ 35, 354 (1992).

When the three initially appointed co-trustees executed the Agreement, they agreed to perform their trustee responsibilities under the Agreement as established by the settlor of the Master Trust, the City. Moreover, the three individuals serving as the Trustee Board at the time the Agreement was executed had the legal authority to execute the Agreement binding all unnamed and successor appointed and participant elected co-trustees to the terms of the Agreement. "Unless otherwise provided in the trust instrument, if a vacancy occurs in the office of a cotrustee, the remaining cotrustee or cotrustees may act for the trust as if they are the only trustees." Cal. Prob. Code § 15621. The Master Trust is an express versus an implied trust as it was created by a formal trust document which established the rights and duties of the parties to the trust. Further, the Agreement clearly reflects the settlor's intention concerning how the initial, and the successor, participant elected co-trustees inability to execute the initial agreement will be treated. The Agreement specifies that "an individual who is elected to serve as a Trustee pursuant to clauses (4) and (5) of section 1.1(h) shall become a Trustee upon execution of a document affirming that he or she accepts the responsibilities imposed by the Agreement on the Trustee and covenants and agrees to perform the same as provided in this Agreement." Agreement § 2.4.

Further, the Agreement states that "Trustee" means and refers collectively to the individuals, who at the time of the reference, are then serving as the co-trustees of the Master Trust. Agreement § 1.1(h).

The unnamed and successor participant elected co-trustees may either accept their duties and responsibilities as provided in the Agreement, or decline to accept their trustee responsibilities. The Agreement explicitly provides that until the co-trustees execute a document affirming their acceptance and agreement to comply with their responsibilities under the Agreement, they may not legally assume their duties to manage the Master Trust. The two initial participant elected co-trustees have executed such a document as required by section 2.4 of the Agreement.

Since the first Trustee Board meeting in August 1996, the Board has struggled with defining its role and authority versus the role of the City in the administration of the Defined Contribution Plans and the Master Trust Fund. The Board has often questioned how its status contrasts with that of the SDCERS's Administrative Board. This memorandum responds to the Board's request for a written legal opinion addressing these areas.

ANALYSIS

A clear understanding of the allocation of powers granted and limited to the City and the Trustee Board is necessary so the Board can avert having its actions or the City's actions declared void by the courts. The duties and responsibilities allocated to the City and the Board, in regards to the SPSP and 401(k) Plans, are specified in the Master Trust Agreement, the Defined Contribution Plan Documents, Federal and State law, and the California Constitution

I. ALLOCATION OF POWER UNDER THE PLAN DOCUMENTS AND THE MASTER TRUST AGREEMENT

The City of San Diego is established under a charter which is the supreme law of the City, subject only to conflicting provisions in the United States and California Constitutions. Grimm v. City of San Diego, 94 Cal. App. 3d 33, 37 (1979). San Diego Charter section 141 authorized and empowered the City Council to establish the SDCERS retirement system and to provide for death benefits for public officers and employees. Further, Charter section 144 established that the SDCERS system will be independently managed by an administrative board.

Unlike the SDCERS Plan, there are no specific legal provisions contained in the City's Charter or the San Diego Municipal Code regarding the City's SPSP and 401(k) Defined Contribution Plans, the Master Trust Fund that holds the Plans' assets, or the Trustee Board. Moreover, there are no provisions in the San Diego Charter that limit the City's authority to

establish defined contribution plans as an integral part of the compensation benefits provided to its employees and officers. Pursuant to Charter section 70, the City Council is authorized to fix the salaries of the City officers and establish the salary and wage schedules for City employees. Charter section 130 requires the City Council to establish by ordinance a schedule of compensation for officers and employees in the classified service prior to the beginning of each fiscal year. Changes to the salary and wage schedules are generally made through the annual salary appropriation ordinance at the time of the preparation and adoption of the budget. Through this Charter authority, the City Council authorized the City Manager to establish the SPSP and 401(k) Plans, in accordance with the adopted Plan Documents, as benefit options for qualified City officers and employees.[4]

Therefore, the duties and responsibilities of the Board, the City Council (as the employer), and the Plan Administrator with respect to the Defined Contribution Plans are specified in the Plan Documents, the Master Trust Agreement, and under federal and state law, instead of in the Charter and the San Diego Municipal Code as they are for the SDCERS Plan.

A. Plan Administrator Duties and Responsibilities

The duties and responsibilities of the Plan Administrator specified in the SPSP and 401(k) Plan Documents include:

1. The responsibility to establish and maintain a Trust Fund for the investment of the Plans' assets, which is to be managed by the Board (SPSP and 401(k) Plans § 5);
2. The responsibility to administer the Plans and construe and apply the Plans' provisions on behalf of the employer which include responsibilities and duties, but are not limited to: (a) deciding questions related to eligibility, continuity of service and amount of benefits; (b) deciding disputes which may arise regarding the rights of participants and beneficiaries under the Plans; (c) compiling and maintaining all records necessary for the Plans; (d) furnishing the employer, upon request, administration reports for the Plans; and (e) authorizing the Board to make payment of all benefits as they become payable under the Plans (SPSP Plans § 10.02; 401(k) Plan § 8.02);
3. The right to delegate to any other person or organizations any of its powers or duties with respect to the operation of the Plans (SPSP Plan § 10.02; 401(k) Plan § 8.02);

[4] For example, the City Council as part of the Fiscal Year 1986 Salary Ordinance authorized the creation of the 401(k) Plan as a benefit option for both the Flexible Benefit and Management Benefit Plans, as described in Resolution No. R-263371, which was adopted on June 10, 1985. San Diego Resolution No. R-272953 (February 27, 1989).

4. The duty to determine entitlement to financial hardship withdrawals (SPSP and SPSP-M Plans § 6.05; 401(k) Plan § 6.01);
5. The responsibility to notify participants and beneficiaries of the denial of claims to Plan benefits (SPSP Plan § 10.07; 401(k) Plan § 8.07);
6. The duty to locate lost Plan Participants and Beneficiaries (SPSP Plan § 14.04; 401(k) Plan § 12.04);
7. The duty to liquidate the trust assets upon a Plan's termination by the City (SPSP Plan § 12.02; 401(k) Plan § 10.02);
8. The right to seek reimbursement from the Trust Fund for all necessary and proper expenses incurred in carrying out these duties under the Plans, including the compensation or fees of accountants, counsel, employees of the City of San Diego and other specialists (SPSP Plan § 10.06; 401(k) § 8.06);[5] and
9. The duty to act as a fiduciary under Federal and state trust law for purposes of administering the SPSP Plans (SPSP Plans § 10.02).

Thus, the Plan Administrator is responsible for the day-to-day administration of the Defined Contribution Plans.

B. Board's Duties and Responsibilities

The Board's rights, duties, and responsibilities are specified in the Plan Documents, the Master Trust Agreement, and under federal and state laws governing trustees' fiduciary responsibilities. The duties and responsibilities delegated to the Board by the City in the Plan Documents include:

1. The duty to invest, manage, acquire, and dispose of the Plan's Trust funds (SPSP Plans §§ 5.02, 13.01; 401(k) Plan § 11.01);
2. The duty to act as trustees and fiduciaries within the meaning of applicable Federal and California trust law with respect to investment, management, and control of the Trust Fund (SPSP § 13.01; 401(k) Plan § 11.01);
3. The responsibility to determine the value of each investment fund and have investment gains and losses posted to participants' accounts (SPSP and 401(k) Plans § 5.03);

[5] Before the March 20, 1995 Amendment to these SPSP and 401(k) sections, Resolution No. R-285505, the City was responsible to pay directly the compensation or fees of accountants, counsel, and other specialists, and other costs of administering the Plans and the Trust. Pursuant to collective bargaining negotiations with the City's four organized labor unions, the City has agreed to continue to pay the costs of administering the Plans and the Master Trust.

4. The duty to keep records and reports regarding the Trust Fund (SPSP and 401(k) Plans § 5.04);
5. The right to be indemnified and held harmless by the City (employer), to the full extent permitted by law, from the effects and consequences of their acts, omissions and conduct in their official capacities, except to the extent that the effects and consequences thereof shall result from their own willful misconduct, breach of good faith or gross negligence in the performance of their duties (SPSP Plan § 10.04; 401(k) Plan § 8.04);
6. The right to seek reimbursement from the Trust Fund for all necessary and proper expenses incurred in carrying out theses duties under the Plans, including the compensation or fees of accountants, counsel, employees of the City of San Diego and other specialists (SPSP Plan § 10.06; 401(k) § 8.06);[6] and
7. The right to approve/reject City proposed amendments to the Plans that increase the duties and responsibilities of the Board (SPSP Plans § 11.01; 401(k) Plan § 9.01).

In the Master Trust Agreement, the City further delegated to the Board the following additional authority and responsibility:[7]

1. The right to appoint the Plan Administrator (Agreement § 1.1(a));
2. The right to use the Trust Fund for the exclusive purpose of providing benefits to the participants and their beneficiaries and for defraying reasonable expenses of administering the Plans, as specified in the Agreement (Agreement § 2.6);
3. The duty to maintain separate accounts for each Plan in the Trust Fund (Agreement § 2.9);
4. The right to receive and hold as part of the Master Trust Plan contributions and transfers without the responsibility to determine if the contributions and transfers are in compliance with the Plans (Agreement § 3.1);
5. The right to make or cause to be made distributions from the Trust Fund as allowed by the Plans (Agreement § 3.2);
6. The right to hold title to the Trust Fund assets (Agreement § 4.1(a));
7. The duty to establish Investment Funds for investment of the Trust Fund assets and to invest the Trust Fund assets in accordance with the investment directions given by each Plans' Participants and Beneficiaries for whose accounts such assets are held (Agreement § 4.2(b));

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[6] Refer to footnote 5.

[7] The responsibilities and obligations of the Board "shall be strictly limited to those set forth in this Agreement." Agreement § 10.4

8. The right to invest the Trust Fund assets in investment funds which contain common stock, preferred stocks, bonds, notes, debentures, mortgages, insurance policies, individual or group annuity contracts, investment contracts, commercial paper, fixed time deposits, money market instruments, mutual fund, common or collective trust funds, pooled investment fund or other investments, including investments offered by an Investment Manager or its affiliate, or securities issued by the City or any subsidiary or affiliate thereof (provided the investment conforms with state law and the "prudent investor" standards of article XVI, section 17 of the California Constitution) (Agreement § 5.29(a));
9. The duty to act as fiduciary over the Trust Fund assets, except to the extent allowable by law, the Participants, not the Board, will be deemed fiduciaries for purposes of Participant directed investment selections (Agreement § 4.2(a));
10. The right to appoint Investment Manager(s) along with the duty to examine and analyze the performance of the Manager(s), to determine what part of the Trust Fund will be under the management of each Investment Manager, and to remove any Investment Manager when necessary (Agreement § 4.3(b));
11. The right to employ suitable agents, including, but not limited to, Custodians, Investment Managers, outside auditors, actuaries, accountants, and outside legal counsel, however, the City will only be obligated to pay such agents' reasonable compensation and expenses incurred by the Board in the performance of their duties under the Agreement, if the expense is budgeted, or, if not budgeted, the expense is approved by four (4) or, if fewer, all of the Co-trustees, and the City gives advance written approval to pay the expense.[8] Also, the City Auditor and the City Comptroller will be the auditor and comptroller for the Master Trust. The City Attorney shall be the chief legal advisor to the Board (Agreement § 5.1(c));
12. The right to incur reasonable Plan and Master Trust administration expenses in the performance of their duties under the Agreement which will be reimbursed by the City if the expense was budgeted, or, if not budgeted, the expense was approved by four (4) or, if fewer, all of the Co-trustees, and the City gave advance written approval to pay the expense (Agreement § 7.1(b));
13. The right to do all acts, whether or not expressly authorized in the Agreement which the Board may deem necessary or appropriate to protect the Trust Fund assets (Agreement § 5.1(e));

[8] If it is unreasonable to obtain the City's advance approval due to unusual time constraints or other similar circumstances, and the expense is clearly necessary for the proper operation of the Trust Fund/ and or the Plans, then the Board need not obtain The City' written advance approval. However, the Board must then immediately inform the City in writing of the type and amount of expense it incurs. Agreement § 7.1(b).

14. The right to commence or defend any action, administrative, judicial or otherwise, and to retain the services of professionals to represent the Board in their trustee capacity (Agreement § 7.5);
15. The right to approve or reject the City's proposed amendments to the Master Trust Agreement that affect the rights, duties, liabilities or responsibilities of the Board (Agreement § 9.1); and
16. The right to establish regulations or rules for removing a Co-trustee from the Board (Agreement § 8.2).

As expressed in the Plan Documents and the Master Trust Agreement, the City delegated to the Board the sole and exclusive authority to administer and invest the Plans' Trust Fund assets.

C. City's Duties and Responsibilities

Likewise, the duties and responsibilities of the City in relation to the Defined Contribution Plans and the Master Trust are specified in the Plan Documents, the Master Trust Agreement, and under Federal and state laws governing employee retirement savings plans. Under the Plan Documents, the City's duties and responsibilities include:

1. The right to appoint the Plan Administrator (SPSP Plans § 10.01; 401(k) Plan § 8.01);
2. The right to amend the SPSP Plans, with participant approval required for amendments that are not required by federal and state laws to maintain the qualified tax status of the Plans and the Trust, and with Board consent for any amendment that increases the duties and responsibilities of the Board (SPSP Plans § 11.01);
3. The right to amend the 401(k) Plan, without participant approval, but with Board consent for any amendment that increases the duties and responsibilities of the Board (401(k) Plan § 9.01);
4. The right to terminate the SPSP Plans in whole or part with participant approval (SPSP Plan §12.01);
5. The right to terminate the 401(k) Plan in whole or part without participant approval (401(k) Plan § 10.01); and
6. The duty to indemnify the Plan Administrator, the Board, and other fiduciaries who are delegated fiduciary responsibility under the Plans, from the effects and consequences of their acts, omissions and conduct in their official capacities, except to the extent that the effects and consequences thereof shall result from their own willful misconduct, breach of good faith or gross negligence in the performance of their duties (SPSP Plan § 10.04; 401(k) Plan § 8.04).

The Master Trust Agreement further specifies the following additional duties and responsibilities of the City:

1. The right to amend in whole or in part the Master Trust Agreement without the Board's consent, except as to amendments which affect the rights, duties, liabilities or responsibilities of the Board. Further, the amendment cannot authorize any part of the corpus or income of the Trust Fund to be used for or diverted to purposes other than for the exclusive benefit of the Plans' Participants and Beneficiaries; to defray the reasonable administration cost of the Plans and the Master Trust; or to permit any portion of the Trust Fund to revert to the City except under specified circumstances (Agreement § 9.1);
2. The right to terminate the Master Trust Agreement and the Master Trust at any time (Agreement § 9.2);
3. The right to designate which of the City's Defined Contribution Plans will be a part of the Master Trust (Agreement § 2.7);
4. The right to designate if all or part of a Plan's interest in the Trust Fund will be held in a segregated account for the Plan and invested separately (Agreement § 2.8); and
5. The duty to notify the Board if a participating Plan is not tax qualified under 26 U.S.C. § 401(a) (Agreement § 2.7).

The delegation of duties and responsibilities by the City to the Board under the Defined Contribution Plan Documents and the Master Trust Agreement is quite different from the delegation of powers granted to the SDCERS Administrative Board under the City Charter. Under the Charter, the SDCERS Board of Administration is granted exclusive control over the administration of the Retirement System, giving the Board exclusive power to define whether SDCERS benefits should be provided in a particular situation. Under the SPSP and 401(k) Plans, the power to administer the Plans is retained by the Plan Administrator. Neither the Plan Documents nor the Master Trust Agreement specifically states that the Board is exclusively responsible to administer the 401(k) and SPSP Plans as they do for the Board's duty to invest and manage the Trust Fund assets. However, upon reviewing the Plan Documents, the Master Trust Agreement, the service agreements with American Express, and the City Council's Resolutions in 1995 and 1996 to amend the Plans, it is clear that the City Council intended and did delegate responsibility to the Board to administer the Plans.

D. <u>Administration Responsibility for the Plans</u>

Under the Defined Contribution Plan Documents, the Plan Administrator is responsible for administration of the Plans. However, under section 1.1(a) of the Master Trust Agreement, the

City delegated to the Board the right to appoint the Plan Administrator. Further, the City Council resolutions, and the supporting Manager's Reports, which justify and establish the creation of the Trustee Board, clearly state that the City intended to establish co-trustees of the Plans "in order to diversify and enhance the range of expertise for monitoring and oversight of plan administration and investment services provided by a third party administrator, . . ." San Diego Resolutions Nos. R-287054 (March 18, 1996), R-285505 (March 20, 1995) (emphasis added). These resolutions amended the SPSP and 401(k) Plan Documents, after participant approval, to provide that the "trust fund may reimburse the Co-trustees for all necessary and proper expenses incurred in carrying out duties under the Plan, . . . provided that those costs and expenses reimbursed from the Trust fund relate solely to administration of the Plan or Trust." SPSP Plans §13.01; 401(k) Plan §11.01 (emphasis added). Thus, the language in the Plan amendments imply that administration of the Plans is one of the duties delegated to the Board.

Further, the City Manager's Report which accompanied Resolution No. R-285505, states that one of the purposes of the proposed amendments which established the Board was to "[a]llow the Trustee to contract for third party administration and investment . . . ." In September 1996, the Trustee Board contracted with American Express Trust Company to assume the duties of a third party administrator, investment manager, and asset custodian to the SPSP and 401(k) Plans. The recitals to the Interim Services Agreements with American Express state that "the Trustees have been assigned certain responsibilities with respect to administration of certain aspects of the Plan," and that "the Trustees desire to have American Express Trust furnish certain ministerial services that are necessary in the administration of certain aspects of the Plan." Further, section IV, O, of the SPSP Service Agreement states that the representatives of the Trustees are to direct American Express on a day-to-day basis with respect to administration of the Plans. Pursuant to section IV, S, the Trustee Board may unilaterally terminate the Services Agreement with American Express. The Deputy City Manager also signed the Interim Services Agreements on behalf of the City acknowledging the Board's delegation of its administrative responsibilities to American Express.

Examining these documents together reveals that the City Council intended to, and did, delegate to the Trustee Board responsibility to administer these Plans. The Trustee Board then delegated administration of these Plans to American Express. Therefore, the current duties and responsibilities of the Trustee Board, which include not only sole and exclusive responsibility to manage and invest the Master Trust Fund, but also to administer the Plans, are comparable to those of the SDCERS Administrative Board. However, there is one significant difference between the two retirement systems which affects the power allocation between the City and the Defined Contribution Plans Board. Under the SDCERS Plan, all of the Plan's administration costs are paid from the earnings on the Plan's assets. Under the SPSP and 401(k) Plans, the Board also has the right to pay for the Plans' reasonable administration costs from the Trust Fund (and in fact American Express' administration costs are taken from the earnings on the Plans'

Trust Fund assets); however, the City has agreed to pay any additional reasonable administrative costs for the SPSP and 401(k) Plans and the Master Trust if the Board follows the safeguard procedures specified in the Master Trust Agreement.

These procedures specify that the Board may obligate the City for all reasonable expenses it incurs in the performance of its duties under the Master Trust Agreement: (1) if the expense is budgeted; or (2) if the expense was not budgeted, it was (a) approved by four or, if fewer, all of the co-trustees; and (b) the City gave its advance written approval or it was not reasonable to obtain the City's advance agreement due to unusual time constraints or other similar circumstance and the expense was clearly necessary for the proper operation of the Master Trust and/or the Plans. Agreement § 7.1(b). If an expense payable by the City is not promptly paid, the Board may pay the expense from the Trust Fund and then "diligently pursue reimbursement from the City for any funds expended from the Trust Fund." Agreement § 7.1(c).

The City's payment of these additional administration costs serves as additional employer contributions to the Plans. However, to minimize the administration costs of these expenses to taxpayers, the City provides the Board with the services of some of the City's staff to assist the Board in administering the Plans and the Master Trust. The City Attorney's Office serves as the Board's chief legal counsel and the City Auditor/Comptroller serves as the Plans' auditor. Agreement § 5.1(c). Further, the Deputy Director of the Risk Management Department serves as the Plans' Administrator with the assistance of four of his staff members.

Thus, the City and the Plans' Participants have delegated to the Board the sole and exclusive authority not only to invest the Trust Fund assets, but also to administer the Plans. The Board has in turn delegated its authority to the Plan Administrator and American Express to administer and invest the Plans and the Plans' assets. The Board's primary duties are to oversee American Express's efficient administration of the Plans and the Trust Fund and to establish appropriate investment funds to allow the Plans' Participants to maximize their investment earnings while adequately diversifying their investments. The City is responsible to set the level of benefits in the Defined Contribution Plans. The Board determines whether Plan benefits should be provided in a particular situation. The autonomy granted to the Board by the City in the Plans and the Master Trust Agreement is consistent with the power allocation contemplated by the voters when they enacted the California Pension Protection Act of 1992.

The Act, commonly known as Proposition 162, amended article XVI, section 17 of the California Constitution, and provides that the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of monies and administration of the system.

As this Office has previously advised, the Act applies to the SDCERS defined benefit plan. 1992 Op. City Att'y 9; City Att'y MOL No. 93-109 (December 15, 1993). Thus, the SDCERS Board has sole and exclusive plenary authority and fiduciary responsibility for investment of the pension funds and administration of the Retirement System. The Defined Contribution Plans Trustee Board questions whether it likewise falls within this constitutional provision.

II. APPLICABILITY OF THE CALIFORNIA PENSION PROTECTION ACT OF 1992 TO THE BOARD

Article XVI, section 17 of the California Constitution authorizes the State and "each political subdivision, district, municipality, and public agency thereof" to acquire and hold shares of common stock when it is held for purposes of furnishing municipal or government objectives. This Section permits public pension or retirement system assets to be invested in these types of investments and specifies the general authority and responsibilities of public pension systems. In November 1992, the California Pension Protection Act of 1992 (Proposition 162) was approved by the voters as an emergency measure. The Act amends article XVI, section 17 of the California Constitution and significantly affects the roles of public agencies and their retirement boards.

Section 3(e) of the Act states that one of the purposes and intents of the measure is "[t]o give the sole and exclusive power over the management and investment of public pension funds to the retirement boards elected or appointed for that purpose, to strictly limit the Legislature's power over such funds, and to prohibit the Governor or any executive or legislative body of any political subdivision of this state from tampering with public pension funds." California Pension Protection Act § 3(e). Thus, the overarching intent of the Act was to protect the assets and the members/beneficiaries of public pension systems by insulating public retirement boards from political interference. While the Act charged retirement boards with exclusive authority over administrative decisions, it also strengthened and clarified these boards' fiduciary obligations and responsibilities.

Specifically, the Act amended article XVI, section 17, of the California Constitution to read, in pertinent part, (the language added to the section by the Act is indicated in bold italics):

> Notwithstanding ***any other*** provisions ***of law or this Constitution*** to the contrary ~~in this section and Section 6 of Article XVI~~, the ~~Legislature may authorize the~~ ***retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for*** investment of moneys ***and administration*** of ~~any public pension or retirement~~ ***the system***, subject to all of the following:
>
> (a) ***The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the***

public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

(b) The ~~fiduciary~~ ***members of the retirement board*** of ~~the~~ ***a*** public pension or retirement system shall discharge ~~his or her~~ ***their*** duties with respect to the system solely in the interest of, and for the exclusive purpose of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expense of administering the system. ***A retirement board's duty to its participant and their beneficiaries shall take precedence over any other duty.***

(c) The ~~fiduciary~~ ***members of the retirement board*** of ~~the~~ ***a*** public pension or retirement system shall discharge ~~his or her~~ ***their*** duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and like aims.

(d) The ~~fiduciary~~ ***members of the retirement board*** of ~~the~~ ***a*** public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly ~~prudent~~ ***not prudent*** to do so.

(e) The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system.

(f) With regard to the retirement board of a public pension or retirement system which includes in its composition elected employee members, the number, terms, and method of selection or removal of members of the retirement board which were required by law or otherwise in effect on July 1, 1991; shall not be changed, amended, or modified by the Legislature unless the change, amendment, or modification enacted by the Legislature is ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed.

(g) The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.

> ***(h) As used in this section , the term "retirement board" shall mean the board of administration, board of trustees, board of directors, or other governing body or board of a public employees' pension or retirement system; provided, however, that the term"retirement board" shall not be interpreted to mean or include a governing body or board created after July 1, 1991 which does not administer pension or retirement benefits, or the elected legislative body of a jurisdiction which employs participants in a public employees' pension or retirement system.***

The Act made five major changes to the constitutional section. These changes grant more independence and impose greater fiduciary responsibility on public retirement boards. Most significantly, it grants public employee retirement and pension systems sole and exclusive authority over not only investment decisions, but also over administration of the system. This reduces the oversight of these activities by public agencies. Next, the Act clarifies that while each board continues to have a duty to minimize employer contributions and to pay reasonable administration costs, a board's primary duty of loyalty is to provide benefits to members and their beneficiaries. Previously, these basic trustee responsibilities were equal. Third, the Act imposes a new duty on boards to administer retirement and pension systems so as to assure prompt delivery of benefits to participants and beneficiaries. Fourth, the measure specifies that the State Legislature cannot change the terms and conditions of board membership unless approved by a majority of the jurisdiction's voters. Fifth, the Act grants each board sole and exclusive power to provide actuarial services.

Moreover, the Act provides that it applies "notwithstanding any other provisions of law or this Constitution to the contrary." Therefore, any existing statute, charter provision, or public agency procedure that usurps or transfers ultimate authority over administration of a public retirement or pension system away from the board that governs that system would be unconstitutional pursuant to this section. Statutes that do not usurp or transfer a board's ultimate authority to decide administrative issues remain permissible, provided that their application does not unduly interfere with the constitutional fiduciary duties imposed exclusively upon retirement boards. Moreover, any decision by a board to use its plenary authority to depart from a permitted statutory administrative scheme must be exercised in conformance with the overriding fiduciary duties imposed on the board by the Constitution.

A. <u>Applicability of the California Pension Protection Act to Charter Cities</u>

The first step in our analysis is to determine what, if any, portions of the Act apply to a charter city, such as the City of San Diego. Under the municipal affairs doctrine contained in article XI, section 5 of the California Constitution, charter cities are provided with a form of "home rule" exemption from general state laws regarding subjects that relate to "municipal

affairs." However, because this Act amends the California Constitution and not general state laws, it is applicable to all charter cities and supersedes any conflicting charter sections, ordinances, and resolutions. This office has already advised that this constitutional section applies to the San Diego City Employees' Retirement System. 1992 Op. City Att'y 9; City Att'y MOL No. 93-109 (December 15, 1993).

B. Applicability of the California Pension Protection Act to the City of San Diego's Defined Contributions Plans

To determine whether the Act also applies to the City's defined contribution retirement Plans, courts will first apply the "plain meaning" rule and look to the language of the measure. Lungren v. Deukemejian, 45 Cal. 3d 727, 735 (1988). If the language is unclear and ambiguous, then courts will look beyond the words of the measure to other evidence of the legislature's intent. Id. In the case of a constitutional provision enacted by the voters, their intent governs. Delaney v. Superior Court, 50 Cal. 3d 785, 795 (1990). In analyzing the language of the provision, "we seek to give meaning to every word and phrase in the statute to accomplish a result consistent with the legislative purpose, i.e., the object to be achieved and the evil to be prevented by the legislation." Harris v. Capital Growth Investors XIV, 52 Cal. 3d 1142, 1159 (1991). The same principle that every word should be given meaning applies to constitutional interpretation. The California Supreme Court stated that "[w]ords used in a constitutional provision 'should be given the meaning they bear in ordinary use.'" Delaney, 50 Cal. 3d at 798.

1. Statutory Language Interpretation of a "Public Pension or Retirement System"

Turning to the language used in the Proposition, its provisions state that it applies to the "retirement board of a public pension or retirement system" and defines the term "retirement board" to mean,

> the board of administration, board of trustees, board of directors, or other governing body or board of a public employees' pension or retirement system, provided, however, that the term 'retirement board' shall not be interpreted to mean or include a governing body or board created after July 1, 1991 which does not administer pension or retirement benefits, or the elected legislative body of a jurisdiction which employs participants in a public employees' pension or retirement system.

Cal. Const. art. XVI, § 17(h). The specific language of the measure does not define what constitutes a "public pension or retirement system" and does not distinguish between defined

benefit plans, i.e. the City's SDCERS Plan, and defined contribution plans, i.e. the City's SPSP and 401(k) Plans.

The word "system" refers to the retirement systems created under California law. For example, California Government Code section 31476 defines "retirement system" under the 1937 County Employees Retirement Law as "each of the systems created and established pursuant to this chapter or its predecessor." California Government Code section 45301 authorizes any city to establish by ordinance a "retirement system" for its employees and officers which provides for any or all of the following: payment of retirement allowances, pensions, disability payments, and death benefits.

Webster's Third New International Dictionary defines "retirement plan" as "a systematic arrangement established by an employer for guaranteeing an income to employees upon retirement according to definitely established rules with or without employee contribution but usually funded - compare 'pension plan.'" Webster's Third New International Dictionary 1939 (1971). Webster's further defines "pension plan" as a "systematic provision by an employer for definitely determinable periodic incomes to employees upon retirement with or without funding . . . ." Id. 1672. Further, Webster's defines "system" as "a complex unity formed of many often diverse parts subject to a common plan or serving a common purpose." Id. 2322. Similarly, Black's Law Dictionary defines "pension plan" as "a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employee, or their beneficiaries, over a period of years (usually for life) after retirement. Retirement benefits are measured by, and based on, such factors as years of service and compensation received by the employees." Black's Law Dictionary 1135 (6th ed. 1990).

As noted earlier, the City's SPSP Plan has been determined by the Internal Revenue Service to meet the requirements of Internal Revenue Code section 401(a) as a tax qualified money-purchase pension plan. The SPSP-M and SPSP-H Plans are highly similar to the original SPSP Plan and are also intended to be tax qualified plans under Section 401(a). Further, the City's SPSP Plans were established as qualified retirement systems in lieu of coverage under the federal Social Security System. "Retirement system" is defined by reference to Section 218(b)(4) of the Social Security Act as a "pension, annuity, retirement or similar fund or system established by a state or its political subdivision thereof." 20 C.F.R 404 (1992); 26 U.S.C. § 3121(b)(7)(F). Thus, the SPSP Plans appear to satisfy the common definitions of a "public retirement or pension system" for purposes of article XVI, section 17 of the California Constitution.

The same is true for the City's 401(k) Plan. The 401(k) Plan is intended to be a tax qualified deferred compensation plan under Internal Revenue Code section 401. The 401(k) Plan also states that the City intended it to be a tax qualified retirement plan. 401(k) Plan § 3.02(e).

The 401(k) Plan also appears to meet the common definitions of a "public retirement or pension system" for purposes of the constitutional provision.

While there are no California cases that interpret whether this constitutional section applies to defined contribution retirement plans, there is an applicable Government Code section that clarifies that this constitutional provision applies to plans that contain deferred compensation funds. California Government Code section 53609 authorizes local agencies to invest deferred compensation plan funds in various types of investments. This section was amended in 1972 to state that "[d]eferred compensation funds are public pension or retirement funds for the purposes of Section 17 of Article XVI of the Constitution." Thus, if the City's SPSP and 401(k) Plans are considered to include deferred compensation funds under the California Government Code, then this section would apply the requirements of the California Pension Protection Act to the City's SPSP and 401(k) Plans.

Black's Law Dictionary defines "deferred compensation" as "compensation that will be taxed when received and not when earned. An example is contributions by an employer to a qualified pension or profit-sharing plan on behalf of an employee. Such contributions will not be taxed to the employee until the funds are made available or distributed to the employee." Black's Law Dictionary 421. The SPSP Plans are qualified money-purchase pension plans. The 401(k) Plan is a qualified profit-sharing plan that contains a cash or deferred arrangement.

Government Code section 53609 specifies that its provision applies to "funds held by a local agency pursuant to a written agreement between the agency and employees of the agency to defer a portion of the compensation otherwise receivable by the agency's employees and pursuant to a plan for such deferral as adopted by the governing body of the agency." The City's 401(k) Trust funds are composed solely of deferred compensation funds from employees' pre-tax compensation and the earnings thereon. Employees' contributions to the 401(k) Plan will be taxed when the funds are received and not when they were earned. The employer contribution portions of the City's SPSP Trust funds are also composed of deferred compensation funds that the City has contributed on behalf of the employees and that will not be taxed to the employees until the funds are made available or distributed to the employees, i.e. upon termination or retirement.

Thus, the City's 401(k) and SPSP Plans are composed of deferred compensation funds and thus courts would likely treat them as coming within the definition of "public pension or retirement plans" for the purposes of article XVI, section 17 of the California Constitution, pursuant to California Government Code section 53609.

2. Voters' Intent Regarding the Public Retirement Systems to Which the Act was Intended to Apply

This statutory language construction is also consistent with the voters' intent in passing the Act. The voters' intent in enacting the measure is to be determined first from examining the language of the measure itself. Delaney, 50 Cal. 3d at 798. The language in the measure is ambiguous concerning whether the voters intended the measure to apply to defined contribution retirement plans as well as defined benefit plans. However, the Act contains a provision which states, "the provisions of this act shall be liberally interpreted to effect their purposes." Section two of the Act states the People's findings and declarations in enacting the measure are to provide special protection to public employees who sometimes must rely exclusively on their public retirement system benefits for financial security in lieu of participation in the federal Social Security System.[9] California Pension Protection Act of 1992 § 2(a).

The City's SPSP Plans were created specifically to provide its participants with retirement coverage in lieu of the City's participation in the Social Security System. Further, for those employees and officers who do not participate in the SDCERS Plan, they must rely exclusively on their SPSP Plans as their primary retirement system from the City. The same principle may apply to the City's 401(k) Plan.

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[9] "The People of the State of California hereby find and declare as follows:

(a) Retired citizens depend upon their pension benefits to meet basic necessities such as food and shelter during their retirement years. For many elderly citizens who are not eligible to participate in Social Security, pension benefits are their sole source of financial support and security.

(b) Teachers, firefighters, police officers and other local, school and state employees depend on promised pension benefits, which must be protected from political abuse and misappropriation.

(c) Politicians have undermined the dignity and security of all citizens who depend on pension benefits for their retirement by repeatedly raiding their pension funds.

(d) Political meddling has driven the federal Social Security system to the brink of bankruptcy. To protect the financial security of retired Californians, politicians must be prevented from meddling in or looting pension funds.

(e) Raids by politicians on public pension funds will burden taxpayers with massive tax increases in the future.

(f) To protect pension systems, retirement board trustees must be free from political meddling and intimidation.

(g) 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.

(h) In order to protect pension benefits and to avoid the prospect of higher taxes, the People must act now to shield the pension funds of this state from abuse, plunder and political corruption." California Pension Protection Act of 1992 § 2.

Where the meaning of terms in an initiative is ambiguous, it is appropriate to consider indicia of the voters' intent other than the language of the provision itself. Legislature v. Eu, 54 Cal. 3d 492, 504 (1991). This includes the analysis and arguments contained in the official ballot pamphlet and materials. Id. There is no indication in the Legislative Analyst's analysis, in the Attorney General's summary of the Act, or in the arguments for or against the Act contained in the voters' pamphlet of this Act, that suggests the drafters/voters intended to exempt public defined contribution retirement plans from the requirements of this constitutional amendment.

The historical background of the Act indicates that it was enacted mainly in response to perceived governmental raiding of the California Public Employees' Retirement System (PERS), a defined benefit plan. Further, in the Analysis of November 1992 Ballot Propositions, the California Senate Office of Research notes that some of the measure's provisions would only effect defined benefit retirement programs, such as "PERS, STRS, and most public pension systems." Senate Office of Research, Proposition 162: The California Pension Protection Act of 1992. Initiative Constitutional Amendment, at 20-21 (November 1992). In particular, the provision providing retirement boards with exclusive authority to provide for actuarial services could fiscally affect defined benefit plans. Id. at 21. The report's summary of the key provisions of the measure however, acknowledges that there are many types of public pension and retirement systems in this State:

> Most government employees in California are members of retirement systems that provide pensions upon retirement if the employees meet certain qualifying criteria. The largest retirement systems in California are the Public Employees Retirement system (PERS) and the State Teachers Retirement system (STRS). In addition, there are over 100 other retirement systems in the state that provide benefits to employee of cities, counties, special districts, and the University of California.
>
> The funds for these retirement systems come from contributions from public employers, from employees themselves, and from the earnings of the investment of the retirement systems. These funds are held in trust by each system's governing board. The members of many public retirement systems elect some of the members of the governing boards. Other members of the governing boards are appointed by the chief executives of the government jurisdiction or by other officials.

Id. at 17. The Report further states that the Act is an outcome of California's budget difficulties and the struggle to find the financial resources to meet budget shortfalls through controlling the

state's retirement systems and the systems' benefits and costs. Id. at 18. Further, the measure is a result of an ongoing series of incidents and legislation relating to the Governor's actions to change the composition of the PERS Board, to capture two PERS reserve funds to offset the State's PERS retirement contributions, and to give the Governor the power to appoint an actuary for the PERS system. Id.

The stated intent of the measure, however, is to protect the independence of *all* public retirement boards and to prohibit the legislative body of any political subdivision of this state from "tampering" with public pension funds. The Act recognized the need for retirement boards to exercise a greater degree of independence from political control because of the fundamental conflict of duties between elected officials, who have obligations to their entire constituency, and retirement board trustees, who have a primary duty of loyalty to the trust's participants and beneficiaries. Thus, applying the California Protection Act to the City's defined contribution plans is consistent with the voters' stated intent in enacting the measure.

3. The City's Intent to Apply the Act to the Board

When the City had an outside consultant prepare the Master Trust Agreement, the Agreement was prepared under the assumption that Proposition 162 likely applied to the City's Defined Contribution Plans Trustee Board.[10] Further, the City already applied some of the fiduciary standards contained in the Act to the Board when it specified the duties and responsibilities of the Trustee Board in the Master Trust Agreement. The Agreement provides that any investment by the Board, in certain types of investments, must conform to the "standards set under paragraphs (b), (c) and (d) of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162 . . ." Agreement § 5.2(b). Further, many of the same Constitutional protections contained in the Act were included in the Master Trust Agreement by the City.

The Agreement specifies that the Trust Fund shall be used for the exclusive purpose of providing benefits to the participants and their beneficiaries, and to defray the reasonable expenses of administering the Plans. Agreement § 2.6; Cal. Const. art XVI, § 17(a). The Board shall have fiduciary responsibility for investment of the Trust Fund assets and the City shall have no rights or claims of any nature in or to the assets of the Trust Fund. Agreement § 4.2; Cal. Const. art XVI § 17. The City is prohibited from making any amendment to the Agreement which authorizes or permits any part of the corpus or income of the Trust Fund to be used for or diverted to purposes other than for the exclusive benefit of the Plans' participants and beneficiaries. Agreement § 9.1. Further, the City is also prohibited from making any amendment to the Agreement which would

[10] Richard Gilbert, the City's consultant who prepared the Master Trust Agreement, stated that the Agreement was drafted under the assumption that the Act applied to the Board.

permit any portion of the Trust Fund to revert to or become the property of the City except in the case of: (1) mistaken contributions to the Plans by the City; (2) the return of any City contributions to the Plans which were conditioned on the Plans' tax qualification; and (3) the return of the residual assets attributable to the City on a Plan's termination upon disqualification. Id.

Further, the Board was given authority to hire its own agents to administer the Plans and the Trust Fund. Pursuant to the administrative agreements signed with American Express and the City, the Board may terminate American Express's services to administer the Plans at any time, without the City's approval. Lastly, the Agreement provides that it will be construed and governed in all respects in accordance with applicable federal law, and in accordance with the laws of the State of California.

Therefore, applying the California Pension Protection Act to the City's Defined Contribution Plans Trustee Board is consistent with the statutory interpretation of the measure, the voters' intent in enacting the measure, and the City of San Diego's intent in creating the Master Trust Agreement. Thus, the Board has not only plenary authority and fiduciary responsibility to invest the Trust Fund, but also to administer the Plans pursuant to the Act.

C. Implications of Applying the California Pension Protection Act to the Board

Public retirement systems are trusts that must be administered by their trustees in accordance with strict fiduciary standards contained both in the express language of the Act and in general trust law that serve the function of oversight of the trustees. Thus, it is necessary to examine the existing procedures and mechanisms for fulfilling the Board's responsibilities to determine if they are appropriate and consistent with their fiduciary duties under the Act. However, not all of the Act's provisions apply to the Board.

1. Applicability of Subsection (f)

Subsection 17(f) of the Act applies to retirement boards that include elected employee trustees. With respect to public pension or retirement boards in effect on July 1, 1991, the number, terms, and method of selection or removal of board members cannot be changed, amended, or modified by the State Legislature unless the action is approved by a majority of the voters in the jurisdiction in which the plan's participants are or were employed. This subsection would not apply to the City's Defined Contribution Plans Trustee Board because the Board was not in effect until after July 1, 1991, and the California Legislature has no authority to specify the members of the City's Board.

The City's Defined Contribution Plans Trustee Board was effective July 1996, when the Plans' Participants voted to increase the Plans' Trustee from one to five co-trustees. Further, as used in the California Constitution, the "Legislature" means the California Legislature, consisting of the Senate and the Assembly. See, generally, article IV of the California Constitution. The provisions of the City's Defined Contribution Plans are set out in the Plans' Documents pursuant to ordinances and resolutions enacted by the San Diego City Council. Any changes to these Plans must be enacted by action of the City Council, not the California Legislature. Thus, the City is not required to obtain the approval of the voters of the City of San Diego before it changes the number, terms, and method of selection for the Defined Contribution Plans Trustee Board. However, any such change would be subject to approval by the SPSP and SPSP-M Plan Participants, the City's organized labor organizations, and possibly the current Board members if the changes increased the duties and responsibilities of the Trustee Board members. SPSP and SPSP-M Plans § 11.01.

2. Applicability of the Fiduciary Standards

As mentioned earlier, the trustees' fiduciary standards set out in the Act are essentially the same as those of the Board set out in the Plan Documents and the Master Trust Agreement. Both provide that the Plans' assets are trust funds and shall be held for the exclusive purposes of providing benefits to participants and their beneficiaries and defraying reasonable administrative expenses. One section of the Agreement, applies the measure's "prudent investor" fiduciary standard to the Board when it makes certain types of investments. Pursuant to the Act, the "prudent investor" fiduciary standard applies to all of the Trustee Board's duties when investing the Plans Trust Fund assets and provides that the Board "shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims." Cal. Const. art. XVI § 17(c).

In addition to the Board's fiduciary responsibilities specified in the Plans and the Agreement, the Board also bears the sole and exclusive fiduciary responsibility, pursuant to the Act, to: minimize employer contributions; administer the retirement system in a manner that will assure prompt delivery of benefits and related services to the Plans' Participants and Beneficiaries; and to put its primary duty of loyalty to its Participants and Beneficiaries over any of its other duties. Cal. Const. art. XVI, § 17(a), (b).

3. Actuarial Soundness of the Plans' Trust Fund Assets

Subsection 17(e) of the Act provides that the retirement board shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system. An actuary is typically used for a defined benefit plan,

to calculate the needed amount of employer contributions to fund the promised level of benefits. This type of actuarial function is inapplicable to a defined contribution plan as the level of the employees' and employer's contributions is fixed and the amount of benefit provided is based on the value of the employees' account balances at the time of retirement.

However, this constitutional provision does impose on the Board the sole and exclusive responsibility to determine the adequacy of the Plans' Trust Fund assets to satisfy the Plans' liabilities. Thus, the sections of the Agreement in which the City attempts to release the Board from responsibility to determine the soundness of the Plans' assets, Agreement sections 7.4(a) and 10.4, are not constitutional because the Board may not delegate this fiduciary responsibility to the City. This exclusive function of the Board is of particular importance considering more than $2 million is being held in trust in the SPSP and SPSP-M Plans' forfeiture accounts for possible permanent forfeitures back to the City to reduce future employer contributions to these Plans.

The unenforceability of this portion of Sections 7.4 and 10.4 of the Agreement, pursuant to the Act, however, does not invalidate the entire Agreement. The Agreement contains a "severability" provision which provides that if any provisions of the Agreement are held invalid or unenforceable, "such invalidity or unenforceability shall not affect any other provisions hereof and this Agreement shall be construed and enforced as if such provision, to the extent [it is] invalid or unenforceable, had not been included." Agreement § 10.7.

4. Administrative Decisions and Procedures

Express protections in the Act impose sole and exclusive fiduciary responsibility over the assets and the administration of the Plans on the Trustee Board such that the Board will be subject to personal liability for losses caused by their acts and decisions that have not been performed or made in accordance with the designated standard of care. Cal. Const. art XVI, § 17(a). Thus, the Board has sole and exclusive authority to make the following types of administrative decisions: (1) determining, appointing, and hiring the number of staff reasonably necessary to administer the system; (2) determining and using appropriate job classifications, and setting competitive salary levels for retirement system staff; (3) entering into outside consultant contracts with experts when it is reasonably necessary for the administration of the retirement system; (4) entering into contracts for services and equipment/goods that are reasonably necessary for the administration of the retirement system; and (5) autonomy to determine and incur reasonably necessary administration expenditures for the system.

The Board may adopt its own budget, independent of the City's budget, subject to its constitutional and fiduciary duty to incur only reasonable administrative costs. Further, the Board is under an additional constitutional duty to minimize the employer's contributions to the Plans to pay for the Plans' administrative costs. While the City is not permitted discretion to veto the

fiduciary administrative decisions of the Board for required expenditures of funds, the City is not required to pay those expenditures unless the Board complies with the procedures specified in section 7.1(b) of the Agreement. This provision in the Master Trust Agreement does not unconstitutionally hamper the Board's ability to administer the Plans and the Trust Fund assets because the Board retains the ability to incur reasonable administration costs that are not budgeted or are not approved by the City for payment. The Board may pay reasonable administration costs from the Trust Fund assets and seek reimbursement from the City should they determine that the City improperly refused to pay the administrative expense. Agreement § 7.1(c); SPSP Plans § 13.01; 401(k) § 11.01.

This level of independence for the Board is necessary because it is the Board, not the City, that has the ultimate fiduciary responsibility to see that promised benefits are paid, and the additional fiduciary responsibility to see that they are paid promptly. Because it is the Board, and not the City, that is subject to fiduciary duties imposing personal liability if they fail to perform these duties, the Board can properly incur necessary or appropriate management costs. The Board must have the authority to make the administrative decisions necessary in order to fulfill its fiduciary duties. Although the Board can properly incur reasonable administration costs, such as employing agents to assist the Board in administering the Plans, the Board is under a duty not to incur a greater administration expense than is reasonable under the circumstances. Restatement (Second) of Trusts § 188 (1959), comment f. Taxpayers, members/beneficiaries, and possibly employers, may sue to hold Board members personally liable for losses caused by acts or decisions that have not been performed or made in accordance with the Boards' standard of care.

Pursuant to Charter sections 80-84, the City has established necessary procedures for the payment of the City's expenses which will safeguard the financial security of the City Treasury. Sections 80 and 82 of the San Diego Charter provide that the Auditor and Comptroller will not issue any warrant or check-warrant until the Auditor and Comptroller verifies that the expense claim is in proper form, correctly computed, duly approved, legally due and payable, that an appropriation has been made for the expenditure which has not been exhausted, and that there is money in the treasury to pay for the expense. These Charter sections are not unconstitutional as applied to the Board because it is possible to construe the sections to mean that the authority of the Auditor and Comptroller extends no further than the role of verifying that the expenditure was: (1) properly authorized by the Board; (2) appropriated in the budget; (3) drawn for the correct amount and from the proper account; and (4) used for the purpose for which they were authorized. Thus the Board must comply with these Charter provisions when incurring administrative expenses for the Plans and the Trust Fund.

5. Compliance with the Open Disclosure Laws

The Board must continue to comply with the Ralph M. Brown Act, requiring open meetings for local legislative bodies, California Government Code section 54950, and the California Public Records Act, California Government Code section 6251. These disclosure laws do not deprive public retirement boards of the power to make final administrative decisions and do not place any other public agency in a position to overturn a retirement board's decision. Further, complying with these acts is consistent with the Board's fiduciary duty to participants and beneficiaries to receive and consider input from all other interested parties.

While the Act amended the Constitution to provide greater autonomy to public retirement boards, it also imposed stricter fiduciary standards on these boards to safeguard the systems' assets from overreaching by the boards' members. Thus, the applicability of Proposition 162 to the City's Defined Contribution Plans Trustee Board likewise provides it greater autonomy from the control of the City, while increasing the fiduciary responsibilities and duties of the Board.

III. THE BOARD'S AUTHORITY TO UNILATERALLY AMEND THE MASTER TRUST AGREEMENT

As the settlor of the Defined Contribution Plans Master Trust, the City reserved the exclusive authority to amend the Master Trust Agreement. Section 9.1 of the Agreement provides:

> The City reserves the right at any time and from time to time to amend, retroactively, if necessary or appropriate, in whole or in part, any or all of the provisions of the Agreement by notice thereof in writing delivered to the Trustee; *provided, however,* that no such amendment which affects the rights, duties, liabilities or responsibilities of the Trustee may be made without its written consent. Any Trustee action under this Section 9.1 shall require the assent of four (4) or, if fewer, all of the individuals then serving as the Trustee. *However,* no such amendment shall authorize or permit any part of the corpus or income of the Trust Fund to be used for or diverted to purposes other than for the exclusive benefit of the Plans' participants and beneficiaries and, if (but only to the extent) specifically authorized by another provision of the Agreement, to defray the reasonable expenses of administering the Plans and the Master Trust, or permit any portion of the Trust Fund to or become the property of the City, except in the following circumstances . . . .

The City did not delegate this authority to the Trustee Board in the Master Trust Agreement. Also, neither the Act nor California trust law provides the Trustee Board with authority to amend the Trust document. This document was created by the City, as the settlor of the Trust, to explicitly establish the duties and responsbilities of the Trustee Board. It would be illogical to allow the Trustee Board the authority to unilaterally amend the Master Trust Agreement to increase or decrease its own powers and responsibilities.

Therefore, the numerous recommended changes to the Master Trust Agreement, that were approved by the Board at the Board meeting on April 11, 1997, will need to be submitted to the City for consideration, and as the settlor of the Master Trust, the City bears the ultimate decision-making power whether to implement these amendments.[11] Agreement § 9.1. Further, the City has retained the exclusive power under the Agreement to terminate the Master Trust and the Agreement at any time. Agreement § 9.2.

IV. THE BOARD'S AUTHORITY TO UNILATERALLY AMEND THE PLAN DOCUMENTS

Pursuant to the Defined Contribution Plan Documents, when the City established the SPSP and 401(k) Plans, the City reserved the exclusive right to amend the Plan Documents. SPSP Plans § 11.01; 401(k) Plan § 9.01. The SPSP and SPSP-M Plans provide:

> The Employer, after approval by a simple majority vote of all active Participants, shall have the right to amend the Plan at any time, and from time to time, to any extent that it deems advisable. Notwithstanding the previous sentence, the Employer shall have the right to amend the Plan at any time to comply with federal or state laws necessary to maintain the qualified status of the Plan. No

[11] The Board approved the following changes to the Master Trust Agreement on April 11, 1997:

(1) the definition of "Plans" should be added to the definition in Article 1.1 that is used in Article 2.7;

(2) the word "City" in section 2.8 should be changed to "Trustees" to indicate which party has the right to specify that all or part of a Plan's interest in the Trust Fund will be held in a segregated account for that Plan and invested separately from the remainder of the Trust Fund; and

(3) to delete the provision contained in Article 5.4 for appointment of alternate Trustees on a temporary basis for Trustees appointed by the City.

> amendment shall increase the duties or responsibilities of the Co-trustees without written consent thereto. No amendment shall be made to this Plan which shall attempt to transfer any part of the corpus or income of the Trust Fund to purposes other than the exclusive benefit of Participants and their Beneficiaries. No amendment shall deprive any Participant or Beneficiary of any benefits to which he or she is entitled under the Plan with respect to contributions previously made to the Plan.

SPSP and SPSP-M Plans § 11.01. The City's exclusive authority to amend the SPSP-H and 401(k) Plans is even more expansive than their authority over the SPSP and SPSP-M Plans as the City does not need approval of the Plans' Participants to make any type of amendment. SPSP-H Plan § 11.01; 401(k) Plan § 9.01.

The City did not delegate this authority to the Trustee Board in the Plan Documents or the Master Trust Agreement. Further, the Act, as it amended the Constitution, does not grant public retirement boards the constitutional authority to determine the level of retirement benefits the employer must provide or authority to amend the retirement plan documents. Thus, the Trustee Board does not have the authority to amend the Defined Contribution Plan Documents.

V. THE BOARD'S AUTHORITY TO INDEPENDENTLY CONTRACT FOR INVESTMENT CONSULTING SERVICES FOR MANAGEMENT OF THE PLANS' TRUST FUND ASSETS

The Trustee Board has asked whether they must obtain the City's approval to contract for investment consultant services related to their management of the Plans' Trust Fund assets. The Board members are trustees and fiduciaries of the Defined Contribution Plans Master Trust Fund. Pursuant to the Defined Contribution Plan Documents and the Master Trust Agreement, the City and the Plans' Participants delegated exclusive authority to the Trustee Board to manage and invest the Plans' Trust Fund assets and to establish appropriate Investment Funds for the investment of these assets. Further, as discussed above, pursuant to Proposition 162, the Board has sole and exclusive constitutional authority to manage and invest the Defined Contribution Plans and the Plans' Trust Fund assets.

The Board would like to retain the services of an investment consultant to assist the Board in evaluating the investment performance of the current investment funds, selecting new investment funds, and evaluating the performance of American Express as the Plans' Investment Manager, Administrator, and Asset Custodian. This is one of the Board's most important fiduciary responsibilities associated with administering and investing the Trust Fund. As previously discussed, the City is constitutionally prohibited from infringing on the Board's

exclusive responsibility for administering the Trust Fund assets. Hence, the City cannot legislatively or administratively require the Board to seek its approval before contracting with an investment consultant to assist the Board in carrying out these exclusive functions. Likewise, the City cannot interfere with the Board's selection process by restricting how the Board should or must go about discharging its fiduciary responsibility in selecting an investment consultant. The Board is, of course, bound by its fiduciary responsibility to exercise the standard of care required of all trustees to act prudently in its selection process. Cal. Prob. Codes § 16002. Therefore, because the contract area pertains to an area of the Board's exclusive responsibility, the Board may contract for an investment consultant without the City's approval.

However, this conclusion depends on the subject matter of the consultant's services. If the Board sought to hire a consultant to perform services that were not related to areas within the exclusive authority of the Board, then the Board would need to obtain the City's approval to hire such a consultant.

VI. APPLICABILITY TO THE BOARD OF THE CITY COUNCIL'S CONSULTANT CONTRACTING POLICIES AND ADMINISTRATIVE REGULATIONS

Professional consultant contracts Citywide are generally not subject to the competitive bidding requirements of San Diego Charter section 28 or 94, nor Civil Service Commission authorization. See 1974 Op. City Att'y 28; 1974 City Att'y MOL 201; 1992 Op. City Att'y 9. However, consultants who are hired under the authority of the City Manager are subject to the provisions of San Diego Municipal Code (SDMC) section 22.0226, which requires the Manager to seek Council approval if the cost of the consultant agreement exceeds $250,000 per fiscal year. City Council Policy 300-7 and Administrative Regulation 25.70 both address Citywide policies with respect to selection of outside consultants applicable to both managerial and nonmanagerial departments.

The Trustee Board has asked whether they must follow these City Council Policies and Administrative Regulations when they contract to hire an investment consultant. If the consultant is providing services that relate to a project or subject matter that is within the exclusive authority granted by the City and the California Constitution to the Trustee Board, then the Board is not required to follow these procedures, because they would infringe on the plenary authority granted to the Board. However, if the consultant's services related to a subject matter within the area of authority retained by the City Council, such as determining the overall level of benefits to be offered through the Defined Contribution Plans, then the Board would need to comply with Council Policy when contracting for the consultant. The decision must be made on a case by case basis, with reference to the nature of the consulting services desired by the Board.

In this case, the Board seeks to hire a professional investment consultant to evaluate the investment performance of the Trust's established Investment Funds, to propose additional Investment Funds that the Board could establish, to evaluate American Express Trust Company's performance as the Board's Investment Consultant, Asset Custodian, and administrator of the Plans.[12] These services relate directly to the Board's exclusive duties to invest and manage the Defined Contribution Plans and the Plans' Trust Fund assets. Therefore, the Board need not follow City Council Policy 300-7 and the related Administrative Regulations when contracting for an investment consultant to perform these types of services.

VII. APPLICABILITY OF THE FEDERAL DRUG-FREE WORKPLACE ACT REQUIREMENTS TO THE BOARD'S INVESTMENT CONSULTANT

The Trustee Board has inquired whether they must comply with the Federal Drug-Free Workplace Act of 1988, 41 U.S.C. §§ 701-706, certification requirements when they select and hire an investment consultant. Section 701 establishes drug-free workplace requirements for federal contractors. Section 702 establishes the same requirements for federal grant recipients. The City has incorporated in almost all of its contracts the requirements of the Drug-Free Workplace Act. This federal legislation and the related regulations require direct federal grantees and contractors to certify that they will provide a drug-free workplace. If a contractor or grantee makes a false certification or violates the certification, that contractor or grantee may be suspended, terminated, or debarred.

If the City is a party to the Board's contract to retain the services of an investment consultant, the contract must comply with the City Council's contracting requirements that require the consultant to comply with the certification requirements of the Drug-Free Workplace Act. However, when the City is not a party to the investment consultant contract, and the Board has independently entered into the contract with the consultant, the issue arises whether the Board must require the consultant to comply with the Drug-Free Workplace Act requirements.

First, the Act's requirements only apply to direct federal contractors or federal grant recipients. A "federal contractor" means the "department, division, or other unit of a person" who is responsible for the performance of a contract for the procurement of any property or services, above a certain value, from any federal agency. 41 U.S.C. §§ 701(a)(1), 706(7). A "federal grant recipient" likewise means the "department, division, or other unit of a person" who is responsible for the performance under a grant from any federal agency. 41 U.S.C. §§ 702(a)(1), 706(6). The Board is not a federal contractor or a federal grant recipient, and the

[12] A Request for Proposal for Investment Consulting Services was submitted to professional investment consulting firms in April 1996, which included these services within the listed scope of work desired by the Board.

Drug-Free Workplace Act requirements do not apply to the Board or to any contractors with which the Board independently contracts. However, like the City, the Board may consider it prudent to incorporate the Act's requirements in all of its contracts to encourage its contractors to take measures to control drugs in their workplaces.

CONCLUSION

There is a delicate balance of power and responsibility between the City and the Trustee Board. Pursuant to the Master Trust Agreement and the SPSP and 401(k) Plan Documents, the City has already delegated to the Board the exclusive power and authority not only to invest the Plans' Trust Fund assets, but also to manage the Plans. Courts would very likely find that the California Pension Protection Act of 1992 (Proposition 162) applies to the City's Defined Contribution Plans Trustee Board. The Act provides that the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of the system's monies and administration of the system. This Constitutional section carves out an exception to a charter city's "home rule" exclusion and applies to the governing bodies of charter cities' retirement and pension systems because it concerns a subject of statewide concern.

Further, the City's SPSP and 401(k) Defined Contribution Plans would very likely be included in the Constitutional section's provisions as "public retirement and pension systems." The Plans fit the ordinary definition of a "public retirement and pension system." Further, the City established the SPSP Plans as qualified money-purchase pension plans in lieu of covering City employees and officers under the federal Social Security System. Both of these Defined Contribution Plans also satisfy the federal Social Security Act's definition of a "retirement system." Moreover, California Government Code section 53609 explicitly states that retirement plans that contain deferred compensation funds, as the SPSP and 401(k) Plans do, are included within the public retirement system provisions of the California Constitution section that the Act amended.

Including the City's SPSP and 401(k) Plans within the Act's provisions is also consistent with the intent of voters in enacting this measure. The measure explicitly states that the People enacted the Act to provide special protection to public employees who sometimes must rely exclusively on their public retirement system benefits for financial security in lieu of participation in the Federal Social Security System. To protect these public pension rights, the boards that govern these retirement systems were granted autonomy from "political meddling and intimidation." California Pension Protection Act of 1992 § 2(f). The analysis and arguments contained in the official ballot pamphlet and materials do not indicate that the voters intended to exclude public defined contribution retirement plans from the Act's provisions. Further, the Act contains a provision which states that the provisions of the Act shall be liberally interpreted to effect their purposes.

The autonomy granted to the Trustee Board by the City in the Plan Documents and the Master Trust Agreement is also consistent with the power allocation contemplated by the voters when they enacted the Act. In the Master Trust Agreement, the City explicitly applied some of the Act's fiduciary investment standards to the Board. As the City has previously acknowledged in the manner it established the Board's duties and responsibilities, it is very likely that courts would find that the California Pension Protection Act of 1992 applies to the Trustee Board.

Because the City initially established the Board's duties and responsibilities assuming that the Act likely applied to the Board, there are no significant necessary changes to the Board's current authority as a result of this conclusion. However, applying the Act's provisions to the Board will impose stricter exclusive fiduciary responsibilities on the Board. In particular, the Board will have the exclusive duty to ensure the competency of the Plans' assets to satisfy the Plans' liabilities. Further, the Board will be subject to the additional Constitutional duties to incur only reasonable administrative costs and to minimize the City's contributions to the Plans. The City, however, is not permitted discretion to veto the fiduciary administrative decisions of the Board regarding required administrative expenditures. If the expense is not budgeted or approved by the City in advance, however, the City may not be obligated by the Board to pay the administrative expense. This procedure does not unconstitutionally infringe on the Board's authority because the Board is authorized to use the Trust Fund assets to pay reasonably necessary administrative costs.

Within this balance of power and responsibilities between the City and the Board, the Board is not required to obtain the City's approval before contracting with an investment consultant who will provide services related to the Board's management and investment of the Plans and the Trust Fund assets. Such a requirement would unconstitutionally usurp the power exclusively vested with the Board to perform these duties by the City Council, the California Constitution, and state and federal law. Further, the Board would not be required to comply with City Council Policies and Administrative Regulations with regard to selecting and hiring a consultant whose services relate to areas within the exclusive jurisdiction of the Board. However, if the subject matter of the consultant's services relates to areas within the City's exclusive jurisdiction, the Board will be required to obtain the City's authorization to hire the consultant and will also be required to comply with the City Council Policies in contracting with the consultant.

Finally, the Board does not have authority to amend the Master Trust Agreement or the Defined Contribution Plan Documents. As the employer and settlor of the Plans' Trust fund, the City retained this exclusive right. The applicability of the Act to the Board does not provide the Board with the additional authority to amend these documents which establish the Board's duties and responsibilities and the level of benefits to be provided under the Defined Contribution Plans.

The City's Defined Contribution Plans
Trustee Board

February 2, 1998

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Deputy City Attorney

LO:cl:084 (x043.2)
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