SAN DIEGO COUNTY EMPLOYEES
RETIREMENT ASSOCIATION

SDCERA
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February 16, 2011

Ms. Mary L. Schapiro, Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Subject: Comments Objecting to Proposed Rule Requiring Registration of Appointed Board Members as "Municipal Advisors;" File No. S7-45-10

Dear Chairman Schapiro:

On behalf of the Board of Retirement of the San Diego County Employees Retirement Association ("SDCERA"), I write to express SDCERA's comments objecting to the proposed rule that would require appointed board members to register with the Securities and Exchange Commission ("SEC") as "municipal advisors."

SUMMARY

First, the rule is unnecessary given the robust system of regulation that all county retirement system trustees – appointed as well as elected – are already subject to under many provisions of California law in the exercise of their well-defined fiduciary duties. Second, the proposed rule will impose unfair and unequal burdens on our appointed trustees, who are an important part of the carefully constructed system of checks and balances built into the statutes developed by the California Legislature to govern the State's county pension systems. Third, the rule will have the unintended negative consequence of discouraging, and in some cases actually preventing, talented community members from serving as trustees, thereby depriving our system, as well as the taxpayers that fund our plan sponsor, of their service and expertise. In sum, to the extent that the SEC's proposed rule is based on the argument that appointed members "are not directly accountable for their performance to the citizens of the municipal entity" (*Commission Release No. 34-63576*, p. 41), the proposed rule fails to recognize the role of appointed trustees in California county retirement systems and that appropriate accountability of both appointed and elected trustees to the members of the systems and to the taxpayers who fund the plan sponsor itself is already well-built into the structure of county systems.

BACKGROUND

SDCERA is a $7.8 billion public pension serving over 36,000 active, deferred, and retired members, all of whom are present or former employees of the County of San Diego and certain other participating public employers. SDCERA was formed in 1939 and exists under the County Employees Retirement Law of 1937, Cal. Gov't Code § 31450, *et seq.* (the "1937 Act"). The composition of SDCERA's nine-member Board of Retirement is established by Section 31520.1(a) of the 1937 Act, and includes balanced representation

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of the membership, the plan sponsor, and the public – specifically, four members elected by the membership (two by general members, one by safety members, and one by retired members); four members appointed by the County Board of Supervisors (including up to one member of the Board of Supervisors itself); and the publicly-elected Treasurer-Tax Collector of the County, who sits *ex officio*. Historically, one of the appointed members has in fact often been an elected Supervisor, as is the case at the present time, leaving only three members who are unelected appointees of the Board of Supervisors.

The fiduciary duties of the members of SDCERA's Board of Retirement are defined in the 1937 Act (*e.g.*, Section 31595), and additionally by the California Constitution (*e.g.*, art. XVI, § 17(b)-(e)). Our trustees are subject to state conflict of interest reporting and continuing education requirements with respect to their duties. (*E.g.*, Cal. Gov't Code § 53235; Cal. Gov't Code § 81000, *et seq.*) SDCERA's Board of Retirement holds two public meetings per month, an administrative meeting and an investments meeting, both of which are subject to the open meeting requirements of the Brown Act. (Cal. Gov't Code § 54950, *et seq.*) SDCERA's records are subject to the California Public Records Act (Cal. Gov't Code § 6250, *et seq.*). In sum, the Board of Trustees is well-regulated and highly transparent in the performance of its fiduciary duties.

COMMENTS ON PROPOSED RULE

Comment 1: Registration of SDCERA's appointed trustees as "municipal advisors" under the SEC's proposed rule is unnecessary because county system trustees are already highly regulated to ensure the proper performance of their duties. Specifically, the proper and lawful fiduciary performance of appointed county retirement systems trustees in California is already subject to at least four levels of control:

First, the appointing authority, which is the publicly-elected Board of Supervisors of San Diego County, screens and selects the appointed members, which are always, under Section 31520.1 of the 1937 Act, a minority of the Board of Retirement. Section 31520.1 does not put any constraints on the exercise of the Board of Supervisors' discretion in selecting appointed members. However, the Board of Supervisors is directly accountable to the public through the election process and therefore selects appointed members with the public interest in mind. The California Legislature made a determination in enacting Section 31520.1 that it furthered the objectives of county retirement systems to entrust the selection of a minority of four members to the Board of Supervisors to ensure that the plan sponsor, and its broader constituency of all voters and taxpayers in the county, had input into the management of the systems. The four appointed members are balanced, in the carefully constructed process set forth in Section 31520.1, by four trustees elected directly by various members groups within the retirement system itself and by the publicly-elected Treasurer-Tax Collector of the County, who sits *ex officio*. In SDCERA's case, there are presently only three non-elected appointed members because the Board of Supervisors has exercised its discretion under Section 31520.1 to appoint one of its own elected members to the Board of Retirement. This composition builds in a strong system of checks and balances into the Board of Retirement because of the variety of interests that are represented – general, safety, and retired member groups; the Treasurer-Tax Collector; a member of the Board of Supervisors; and three appointed members with diverse backgrounds and different perspectives as taxpayers and members of the broader local community. Imposition of a registration requirement as proposed by the SEC would interfere with the purpose and implementation of Section 31520.1 by placing an additional requirement on appointed members that is not imposed on other members and which will serve, as explained in our subsequent comments, as a barrier to the selection of qualified appointed members.

Second, beyond Section 31520.1, the 1937 Act extensively regulates all of the trustees, including appointed trustees, in the performance of their duties. The 1937 Act is a lengthy and complicated statute which provides detailed direction as to all aspects of the operation of the retirement system. The 1937 Act specifically defines the fiduciary duties of all trustees, including their duties with respect to the investment of fund assets. For example, Section 31595 provides:

> The board has exclusive control of the investment of the employee's retirement fund. 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. Except as otherwise expressly restricted by the California Constitution and by law, the board may, in its discretion, invest, or delegate the authority to invest, the assets of the fund through the purchase, holding, or sale of any form or type of investment, financial instrument, or financial transaction when prudent in the informed opinion of the board. The board and its officers and employees shall discharge their duties with respect to the system:
>
> (a) Solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system.
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> (b) 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.
>
> (c) 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 to do so.

All trustees, including appointed trustees are bound by these duties, ensuring that the Board of Retirement's investment functions, and all of its responsibilities, are performed properly and in the interest of the system and the public. The SEC's proposed rule does not add anything of substance to the duties already laid out in the 1937 Act.

Third, the fiduciary duties of county retirement system trustees are not just a matter of statute or common law in California – they also have constitutional dimension. The California Constitution imposes specifically defined fiduciary duties on all county system trustees, including appointed trustees. Article XVI, section 17(b)-(e) of the California Constitution provides:

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

(c) The members of the retirement board of a public pension or retirement system 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.

(d) The members of the retirement board of 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 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.

These provisions include modifications made in 1992 through the statewide initiative process (Proposition 162, approved November 3, 1992), reflecting the voting public's endorsement of the system of regulation set forth in the California Constitution for the protection of public retirement system assets and the criteria defining the fiduciary duties of retirement board members. Upon becoming a trustee of SDCERA, an individual must take an oath or affirmation that includes allegiance to California constitutional requirements. The constitutional significance of the duties of county system trustees, including their duties with respect to investment matters, provides another compelling reason why the SEC's proposed rule requiring registration of appointed members is unnecessary.

Fourth, county retirement system trustees are subject to various other statutory and regulatory requirements under California law, including the California Fair Political Practices Commission, which require reporting as well as continuing education to prevent conflicts of interest and other breaches of duty. For example, SDCERA requires that, every two years, all of its trustees completed two hours of ethics training as described in California Government Code Section 53235. The training is provided by the California Fair Political Practices Commission. *See* http://www.fppc.ca.gov/index.php?id=477. This training covers all relevant ethics laws, which are defined by Section 53234(d) to include:

(1) Laws relating to personal financial gain by public servants, including, but not limited to, laws prohibiting bribery and conflict-of-interest laws.

(2) Laws relating to claiming perquisites of office, including, but not limited to, gift and travel restrictions, prohibitions against the use of public resources for personal or political purposes, prohibitions against gifts of public funds, mass mailing restrictions, and prohibitions against acceptance of free or discounted transportation by transportation companies.

(3) Government transparency laws, including, but not limited to, financial interest disclosure requirements and open government laws.

(4) Laws relating to fair processes, including, but not limited to, common law bias prohibitions, due process requirements, incompatible offices, competitive bidding requirements for public contracts, and disqualification from participating in decisions affecting family members.

In addition, under California's Political Reform Act, all county retirement system trustees, including appointed trustees, are required to file annual conflict of interest reports and are subject to the state's conflict of interest rules and regulations. (*See* Cal. Gov't Code § 81000, *et seq.*) California law also makes it clear that appointed board members cannot market their firm's financial services to the system they serve or any other 37 Act system. Beyond the laws directly applicable to the trustees, other provisions of law regulate those who market investments to county retirement systems. For example, California has strong placement agent laws (*see, e.g.,* Cal. Gov't Code § 7513.85), and SDCERA has adopted a Placement Agency Policy to enforce these requirements. The various provisions of California law mentioned here, as well as others which are beyond the scope of this letter, further demonstrate that the concerns motivating the SEC's proposed registration requirement for appointed trustees are already adequately addressed in the comprehensive regulatory system that applies to California county retirement systems, and all of their trustees, such that there is no need for the proposed SEC rule.

Comment 2: The requirements outlined in Comment 1 above all apply equally to all trustees and ensure that all of the trustees are subject to a uniform system of regulation in the performance of their fiduciary duties. The SEC's proposed rule would create a deviation from this approach in singling out non-elected appointed trustees for the special and burdensome requirement of registering as "municipal advisors." Appointed and elected trustees are all "advisees" with respect to proposed investments, not advisors. All of the trustees rely on the system's investment staff, outside consultants, and other expertise in setting and implementing investment policy. Under the 1937 Act and the California Constitution, none of SDCERA's trustees is acting as an investment professional in serving as a trustee; the trustees are charged with fulfilling their investment responsibilities on behalf of the system based on a "prudent person" standard. Some of the appointed (and elected) trustees indeed have financial backgrounds, but they act only as members of the broader community when serving as trustees. The duties and responsibilities of appointed trustees, and the approach they must take to their work as trustees, are exactly the same as the elected trustees. There is, therefore, no reasonable basis to impose a special SEC registration requirement upon them.

As we understand it, the SEC's rationale for proposing this unequal treatment is that appointed trustees are not directly accountable through an election process to the membership of the pension system or to the public constituency of the plan sponsor. While it is true that three of SDCERA's appointed trustees are not "elected," they are no less accountable to SDCERA's membership or to the public than other trustees. Elections are not the only legitimate form of accountability. As we have explained above, the Legislature and the people of California have expressed their approval in many ways of the strong system of existing trustee regulation. The existing system of regulation has multiple redundancies, including extensive policing by SDCERA, the Board of Supervisors, the membership and the public, and the Fair Political Practices Commission, among others. This regulatory scheme, with its many moving parts, is *constantly* in action ensuring proper conduct by all trustees. Discriminating between elected and appointed trustees on the basis of an "election," which only occurs every *three years* with respect to the membership-elected trustees and only every *four years* with respect to the Treasurer-Tax Collector and Supervisor members, seems questionable on its face.

Sound policy, which SDCERA strongly endorses, should be based on constant and equal regulatory requirements applicable to all trustees – without any discrimination between them – and that's what achieved by California rigorous existing regulation of county retirement system trustees.

Comment 3: Ultimately, one of the greatest concerns that SDCERA and its Board of Retirement has concerning the proposed SEC rule is that it will discourage, and in some cases actually prevent, qualified individuals from serving as trustees, and will therefore affirmatively disadvantage the Board in the performance of its important responsibilities. The time commitment and investment of energy that is required on the part of our appointed trustees, as with the elected trustees, is enormous. They serve out of public-mindedness, not out of any possibility of self-interest, reward, or compensation. Having to complete an additional layer of federal paperwork to become a "municipal advisor" subject to the jurisdiction of the SEC would be a significant burden on these individuals, particularly since it will not apply to any of their co-trustees who are performing exactly the same duties. SDCERA believes that many qualified candidates to serve as appointed trustees will decline to serve because of this special additional burden imposed only on them. In addition, certain individuals, because of their employment in the private sector, are subject to restrictions by their employers that preclude individual registration of the type proposed by the SEC. In fact, as direct evidence to support SDCERA's concern, SDCERA is aware that one of its effective current appointed trustees may be required by their employer, because of regulatory requirements and policies that exist in the employer's business, to resign from the Board if the proposed rule becomes effective. Thus, the proposed SEC rule will have the negative effect of discouraging or preventing well-qualified members of the community from serving as appointed trustees, and will thereby impair the work of county retirement systems.

CONCLUSION

We hope that our comments are helpful and cause the SEC to reconsider its proposed rule requiring registration of appointed trustees as "municipal advisors." The conduct of appointed trustees to the same standard as elected trustees is already ensured by numerous provisions of California law, who are accountable to SDCERA's membership and to the public through these laws. The SEC's proposed rule, therefore, would not improve regulation of the conduct of appointed trustees, but it would have the negative effect of discouraging qualified and public-minded members of our community from providing their expertise to SDCERA and its active, deferred, and retired members, as well as the public at large, in the management of the pension system.

Thank you for your consideration of SDCERA's comments.

BWhite

Brian P. White
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