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PENSION FUND COMMITTEE

Minutes of Meeting

November 13, 2013

The Sussex County Pension Fund Committee met on November 13, 2013, at 10:00 a.m. in the County Council Chambers, Georgetown, Delaware. Those in attendance included members: Gina Jennings, Todd Lawson, Karen Brewington, Jeffrey James, David Baker, and Hugh Leahy. Also in attendance were John Lessl of Aon, the County's Actuary, as well as Michael Shone of Peirce Park Group, the County's Investment Consultant. Committee member Lynda Messick was unable to attend.

On November 5, 2013, the Agenda for today's meeting was posted in the County's locked bulletin board located in the lobby of the County Administrative Office Building, as well as posted on the County's website.

Ms. Jennings called the meeting to order.

Approval of Minutes

The minutes of the August 15, 2013 meeting were approved by consent.

Actuarial Assumptions

It was explained that an experience study had been completed for the pension plan to review the County's actuarial assumptions. Ms. Jennings introduced Mr. Lessl who noted that the study reflects actual performance/experience versus the assumptions used for valuation for the past 5 years. The following assumptions were used for the experience study: retirement rates, termination rates, salary increases, COLA, marital assumptions, and payroll growth. Mr. Lessl noted that an experience study provides information that can provide justification for the assumptions used, test the accuracy of the assumptions, make revisions to improve the assumptions, and show the cost impact if changes are made. The cost impact

would be affected by any applicable offsetting changes. Any changes implemented would be effective as of the January 1, 2014 valuation.

Retirement Rates (not including paramedics and dispatchers)

Information given included exposure, current assumptions, actual experience, and recommendations. Over the 5-year period, the study reviewed how many times an employee was eligible to retire (exposure), whether they did so or not. The study reflected that there were 19 occasions for early retirement and 83 for normal retirement. Significant retirements occurred after 30 years of service regardless of age, which was very different for retirements strictly based on age. Retirement information was given in three components: early retirement, normal retirement (age 62), and those with 30+ years of service.

Actual experience reflected 2 early retirements and 18 normal retirements over this 5-year period. Mr. Lessl met with Michael Schooley of Aon, actuary for the OPEB Plan, and together made recommendation as to the assumptions to be used: for example, 10 percent of employees elect early retirement at age 60 and another 10 percent at age 61, or 1.9 retirements. Early retirement is considered at 60 years of age, with 15+ years of service. It was mentioned that the numbers reported could be inflated due to two early retirement incentive options offered during this 5-year period; it was thought that 12 employees took advantage of these early retirements. Full retirement for social security is now at the age of 66 and 67 versus 65. Ms. Brewington will provide Mr. Lessl with the pertinent information regarding these two early retirement options and Mr. Lessl, in turn, will revise the numbers reported.

30 plus years of service – The early retirement incentives did not impact the eligibility for this particular segment of employees, other than adding years when computing their pension. During this 5-year period, actual experience reflected 18 employees retiring.

Dispatchers and Paramedics – The current assumption is 100 percent retirement after 25 years of service. Mr. Lessl noted that there was not sufficient data to allow recommendations so it is recommended that the 25 years of service remain in place.

Taking into consideration the recommended changes for the retirement assumptions, Mr. Lessl noted that an increase of $167,064 would be realized for the annual required contribution.

Termination Rates

Males – Termination tends to be a function of both service and age. Mr. Lessl stated that fewer employees terminated than the current assumption. The recommended assumptions include:

	<1	1	2	3	4	5	6+	
<20								0.0
20-24	22.0%	16.0%	17.6%	9.8%	9.1%	6.4%		3.8
25-29	16.7%	12.6%	14.4%	8.4%	7.8%	5.7%	8.2%	8.6
30-34	13.0%	10.1%	11.5%	6.4%	5.9%	4.4%	6.6%	7.5
35-39	9.5%	7.5%	8.0%	5.1%	4.7%	3.4%	5.1%	6.5
40-44	8.5%	6.2%	6.8%	4.0%	3.8%	2.6%	4.1%	7.3
45-49	7.0%	4.7%	5.3%	3.0%	2.7%	2.1%	3.1%	5.6
50-54		3.3%	3.8%	2.2%	2.1%	1.4%	2.1%	2.7
55-59		6.0%	6.0%	3.6%	3.6%	3.0%	3.0%	4.4
60-61		20.0%	20.0%	12.0%	12.0%	10.0%	10.0%	9.0
	1.3	4.4	5.8	4.5	5.4	4.3	29.9	55.4
Recommended Factor	2.0	2.0	2.0	1.2	1.2	1.0	1.0	
Current Factor	4.0	4.0	3.0	2.5	2.0	1.5	1.0	

While actual experience shows similar male terminations versus the current assumption, 56 and 58.11 respectively, Mr. Lessl noted that their distribution was quite different. Mr. Lessl noted that he and Mr. Schooley felt that similar 6+ years of service rates could be recommended with the exception of 3 percent for ages 55-59, and 10 percent for ages 60-61.

Females – Mr. Lessl noted that female employees have a different pattern of termination. The recommended assumptions include:

	<1	1	2	3	4	5	6+	
<20								0.0
20-24	32.0%	13.6%	6.4%	6.3%	5.6%	9.8%		1.7
25-29	25.8%	11.9%	5.5%	5.3%	4.8%	8.5%	6.1%	4.6
30-34	19.7%	9.5%	4.2%	3.9%	3.6%	6.8%	5.1%	4.0
35-39		6.5%	3.1%	3.0%	2.9%	5.2%	3.8%	3.4
40-44	12.5%	5.5%	2.6%	2.5%	2.3%	4.1%	3.0%	3.9
45-49	10.0%	4.6%	2.1%	1.9%	1.8%	3.1%	2.3%	3.6
50-54		3.0%	1.3%	1.3%	1.3%	2.1%	1.6%	1.5
55-59		4.8%	2.0%	2.0%	2.0%	4.0%	2.0%	2.3
60-61		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0
	2.0	2.1	1.3	1.7	1.7	3.2	13.0	25.0
Recommended Factor	2.0	1.2	0.5	0.5	0.5	1.0	0.5	
Current Factor	4.0	4.0	3.0	2.5	2.0	1.5	1.0	

Taking into consideration the recommended changes for the termination assumptions, Mr. Lessl noted that an increase of $76,605 would be realized for the annual required contribution.

Salary Increases

The current annual salary increase assumption has been 5 percent. During the last five years, the actual experience has shown a smaller increase, averaging 2.9 percent. It is being recommended to not use a constant salary increase assumption, but rather one that varies by age. The recommended percentages include:

Age	Recommended
<20	
20-14	4.5%
25-29	5.5%
30-34	5.0%
35-39	4.5%
40-44	3.5%
45-49	3.5%
50-54	3.5%
55-59	3.5%
60-64	3.0%
65-69	3.0%
70+	3.0%
	3.8%

The above salary scale changes are recommended only if the assumed 8 percent rate of return is to lowered to 7.5 percent.

Taking into consideration the recommended changes for the salary scale assumptions, along with a 7.5 percent assumed rate of return, Mr. Lessl noted that an increase of $8,831 would be realized to the annual required contribution.

COLA (Pension Plan)

The average COLA increase for the last 5 years was 1.230 percent, and 1.365 percent for the past 10 years. The current assumption is 2.0 percent; Mr. Lessl is recommending 1.250 percent. Currently, pensioners are given half of what active employees receive, up to a maximum of two percent. Although not included in the information, Mr. Leahy felt 1.250 percent was too low based on the average 3.8 percent recommended salary increase assumption discussed earlier. Ms. Jennings stated that pensioners did not receive a COLA increase during the 2014 budget

year. In private industry, Mr. Leahy noted that it was unusual to see COLA increases for pensioners.

Mr. Shone noted that, possibly, a 1.50 percent COLA assumption would be more reflective of the 3 percent salary increase assumption for employees 60+ years of age.

Mr. Lessl noted that the County's method of providing COLA increases is a very sound approach compared to other plans having an automatic increase.

Taking into consideration the recommendation of a 1.250 percent COLA assumption, Mr. Lessl noted that a savings of $409,184 would be realized to the annual required contribution.

Marital Assumptions

It is currently assumed that there is a 3-year age difference between male employees and their spouse. Although not a huge cost factor, the actual age difference is one year. The current assumption is also that 100 percent of employees are married, whereas the actual total is 61.7 percent for married employees and pensioners. Mr. Lessl felt that when this 100 percent assumption was made, the County was not able to provide data regarding retiree spouses. It is recommended that an overall assumption of 65.0 percent be used for active employees.

With pension plans that provide both employee and spousal protection, Mr. Lessl noted most plans reduce the participant's pension benefit. The County automatically provides the spousal benefit with no adjustment to the employee's pension. This is known as a fully subsidized joint and survivor benefit, which does have a greater impact to the County's plan.

Taking into consideration the recommended marital assumption that 65 percent of employees are married, Mr. Lessl noted that a decrease of $105,412 (actives only) would be realized. An additional $100,000 savings would be realized if this assumption is used for retirees as well.

Ms. Brewington left the meeting.

Payroll Growth

Payroll growth, currently 3.5 percent, is used as part of the methodology for amortizing the County's unfunded liability. There are two components of the County's required contribution: the current year's contribution and the contribution needed to make up for any shortfall. If there is underfunding, that

amount is amortized and added to the current year's contribution requirement. There is great variation in amortization methods used by governmental entities. The County uses a process that involves amortizing the entire unfunded amount every year over a 30-year period, using a 3.5 percent payroll growth assumption; this process does not cover the interest on the unfunded amount, which Mr. Lessl explained would prohibit the pension plan from ever being fully funded.

The Committee discussed various options and noted the importance of addressing this issue. Taking into consideration the recommended 2.5 percent payroll growth assumption, Mr. Lessl noted that an increase of $74,935 would be realized. Reducing the payroll growth assumption to zero, the total increase would be approximately $200,000.

In light of increased reporting regulations, Mr. Leahy expressed the importance of the County having a clear method to reduce and/or eliminate any unfunded liability over a reasonable period of time.

Ms. Jennings felt the County should have a goal to have a fully funded pension plan, and mentioned a zero percent payroll growth assumption.

Taking into consideration all of the above recommended assumptions changes, Mr. Lessl reported an overall savings of $183,961 in the annual required contribution would be realized, or a total savings of approximately $283,961 when using actual retiree spouse data.

In an effort to assist with these assumptions, Ms. Jennings stated that it was her intention to have an experience study performed every 5 years.

Mr. Leahy stated concern over a 30-year approach to eliminate the unfunded pension liability and would like to see a more aggressive methodology of addressing any unfunded liability.

Ms. Jennings referred to Mr. Shone's November 4, 2013 letter that was included in the information packet. Based upon the County's asset allocation mix and conservation investment approach, Peirce Park would like to see the County's assumed rate of return at no more than 7.5 percent. The packet also contained a study entitled, "NASRA Issue Brief: Public Pension Plan Investment Return Assumptions", which reflected that most governments are making the transition of decreasing their assumed rate of return; the state-by-state return assumptions showed Delaware currently using a rate of 7.5 percent. Ms. Jennings stated that the County's auditors are also making the recommendation for a 7.5 percent assumed rate of return.

Ms. Jennings noted that any assumption recommendations would be brought before Council at their December 10, 2013 meeting.

Regarding the retirement rate assumption, it was the consensus of the committee for Mr. Lessl to provide revised retirement figures taking into consideration the two early retirement options, which will be shared with the Committee prior to making recommendation to Council.

A Motion was made by Mr. Leahy, seconded by Mr. Baker, to make recommendation to the Sussex County Council to adjust the termination scale assumption as included in the chart entitled "Sussex County Employee Pension Plan Termination – Male (Recommended)" and "Sussex County Employee Pension Plan Termination – Female (Recommended)".

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

A Motion was made by Mr. Leahy, seconded by Mr. Baker, to make recommendation to the Sussex County Council to reduce the assumed investment rate of return for the Pension and OPEB Plans to 7.5 percent and adjust the salary scale assumption as included in the chart entitled "County of Sussex Pension Plan Salary Increases (Recommended)".

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

A Motion was made by Mr. Leahy, seconded by Mr. Baker, to make recommendation to the Sussex County Council to adjust the COLA assumption to 1.4 percent.

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

A Motion was made by Mr. Leahy, seconded by Mr. Baker, to make recommendation to the Sussex County Council to adjust the married marital status assumption to 65 percent for active employees.

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

A Motion was made by Mr. Leahy, seconded by Mr. Baker, to make recommendation to the Sussex County Council to adjust the payroll growth assumption to zero percent (while continuing to look at other options).

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

Ms. Jennings thanked Mr. Lessl for his time and presentation.

Mr. Shone suggested a slight revision to the sequence of the remaining agenda items.

Performance Reports of the Pension and OPEB Funds

Mr. Shone provided copies of the "Sussex County Investment Performance Report – September 30, 2013", which included 2 subsections for the County's Pension and OPEB Funds, as well an introductory section regarding the overall Market Environment for the third quarter of 2013. Also provided were a quarterly newsletter, "Peirce Park Perspective – Fall 2013", as well as a October 31, 2013 update on the OPEB Fund. Although the Investment Performance Report should be referenced for a more detailed analysis, highlights discussed include:

Mr. Shone noted that the stock markets performed very well during the third quarter, which was far better than anticipated; also anticipated was the slightly negative performance of the bond markets.

Market Environment – 3rd Quarter

- The fiscal year 2013 Federal deficit will be four percent of the Gross Domestic Product, compared to more than 10 percent in 2009.
- The job separation rate (quit rate versus laid off) reflects an increased quit rate, which is a positive sign of an improving labor market; workers typically quit when they have found other employment or are comfortable with their ability to secure another position.
- Although positive, the average hourly earnings growth rate of 2.2 percent in the 12 months ending August 2013 was below the 3.1 average growth rate, which impacts consumer spending and encourages the use of personal savings.

- U. S. equities, as of the end of September, were up 20 percent for the year; international equities were up 14.7 percent; U. S. bonds were down for the year; and high yield bonds up 3.7 year-to-date and 2.3 percent for the quarter. The County does not have direct exposure to junk bonds, other than what may be contained within the State Pool;

- Inflation-sensitive investments have been sharply negative for the year; and

- On average, small cap bonds were up 27.7 percent; mid cap – up 24.3 percent; and large cap – up 20.8 percent.

Tab II – Pension Fund

- Portfolio gained $2.4 million during the quarter – 4.2 percent gross return (approximate year-to-date gain of $6.6 million, or 11.7 percent);

- Looking ahead/items to consider: actuarial return assumptions and investing the 2013 annual required contribution (ARC);

- As of September 30, 2013, the ending market value of the Pension Fund was $62,514,074, a 12.5 percent one-year return;

- For the quarter, the Pension Fund had a 4.2 percent return, and ranked in the 21 percentile nationally for the year-to-date. Although the County has a lower allocation in equities, the types of equities are more conservative in nature. At the current time, the County has 12 percent in equities; Mr. Shone would recommend a change to 14 percent. International equities are slightly more volatile than domestic; and

- The County's expense ratio is .59 percent, which is higher than the rest of Peirce Park's public funds, but is due to the State Pool; their returns offset this additional cost.

Tab III – OPEB

- Portfolio gained $1.1 million net (of investment expenses) during the quarter – 4.4 percent gross return (year-to-date gain of $2.5 million, or 10.3 percent). The OPEB Plan has very low investment manager fees;

- Looking ahead/things to consider: actuarial return assumptions, increase international target (12% to 14%), further international equity diversification, more active large cap stock diversification, and investing 2013 ARC;

- Ending market value – $27,102,650, year-to-date return of 10.3 percent; one year return – 11.4 percent, and two year return – 12.0 percent;

- The OPEP plan ranked in the 63rd percentile for the quarter, 44th for year-to-date; 57th percentile for the one-year ranking, and 80th percentile for the two-year ranking; and

- The County's expense ratio was 32 basis points, or .32 percent.

Mr. Shone referred the Committee to a separate handout, "Sussex County OPEB – Total Fund as of October 31, 2013". With a one month return of 2.7 percent, the year-to-date return was 13.0 percent. The ending market value as of October 31, 2013 was $27,842,168.

Annual Contribution/Investment for Pension and OPEB Funds

Mr. Shone distributed two rebalancing handouts regarding the annual required contribution for both the Pension and OPEB plans.

A Motion was made by Mr. Baker, seconded by Mr. James, that the Sussex County Pension Fund Committee recommend to the Sussex County Council to invest the 2014 Pension Fund annual required contribution of $3,087,012 in treasuries with the Wilmington Trust Company.

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

Mr. Shone noted that in speaking with Mr. D'Eramo, of Wilmington Trust, they would not charge an investment management fee, only a custody fee (approximately 3 to 5 basis points).

A Motion was made by Mr. Leahy, seconded by Mr. James, that the Sussex County Pension Fund Committee recommend to the Sussex County Council to invest the 2014 OPEB Fund annual required contribution of $1,933,752 in short-term treasuries with the Wilmington Trust Company.

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

Peirce Park Proposal

Ms. Jennings explained that the next topic for discussion was Peirce Park's proposals for increased services to manage the OPEB fund, with the intent for

better performance. Mr. Shone provided a letter dated November 5, 2013 explaining several consultant service options, as well as the fees involved:

Option 1: Continue as is, but with 4 or 5 recommended changes to the fund

Option 2: Peirce Park selects the funds, with weekly reviews by Peirce Park; a very hands-on approach

Option 3: Similar to Option 2, with weekly reviews by Peirce Park, but the County would still have the ultimate authority to make decisions

Options 2 and 3 would have extra cost (20 basis points) due to additional work and liability for Peirce Park. At the current time, Peirce Park is paid .1 percent in consultant fees.

With Options 2 and 3, possible Peirce Park recommendations would include:

1. On the bond side, no immediate changes would be made at this time;
2. On the stock side, add one additional large cap;
3. Increased diversification on the international side – probably four funds instead of two;
4. Increase international funds to 14 percent;
5. Increase diversification in the mid and small cap area; and
6. Weekly meetings – including rebalancing

Discussion was held regarding the various consultant service options.

With Option 2, Peirce Park's specific recommendation would still be brought before the Pension Committee.

Ms. Jennings stated that she does not feel comfortable regarding the extra fees and making decisions without the Committee's input.

Mr. Shone recommended that the County try Option 3 for 12 months, with Peirce Park waiving any related costs. At the end of that time period, if the County determined the services to be worthwhile, Peirce Park would receive compensation for the additional OPEB consultant services.

A Motion was made by Mr. Leahy, seconded by Mr. Baker, to accept Option 3 offered by Peirce Park Group, with fees deferred 6 months to a year, based on performance.

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea: Mr. Lawson, Yea; Ms. Jennings, Yea

Ms. Jennings thanked Mr. Shone for his time and presentation.

Pension Investment Policy Statement Update

Ms. Jennings distributed copies of a booklet entitled, "Employee Pension Investment Policy Statement – Proposed Revisions", which contained the current Investment Policy Stated adopted in 2007; recommended changes and the reasons for such changes; and a final copy of the IPS with recommended revisions. Members are to review the information for discussion at the February 2014 meeting.

2014 Meeting Dates

Ms. Jennings announced the quarterly meetings for 2014: February 20, May 15, August 21, and November 13. All meetings begin at 10:00 a.m. and are held in the Sussex County Council Chambers.

Additional Business

Ms. Jennings reiterated that the Committee's recommendations will be brought before Council at their December 10, 2013 meeting, with Mr. Shone in attendance.

At 12:22 p.m., a Motion was made by Mr. Leahy, seconded by Mr. Baker, to adjourn.

Motion Adopted: 5 Yea.

Vote by Roll Call: Mr. James, Yea; Mr. Baker, Yea; Mr. Leahy, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

Respectfully submitted,

Nancy Cordrey

Nancy J. Cordrey
Administrative Secretary