PENSION FUND COMMITTEE

Minutes of Meeting

May 16, 2013

The Sussex County Pension Fund Committee met on May 16, 2013, at 10:00 a.m. in the County Council Chambers, Georgetown, Delaware. Those in attendance included members: Susan Webb, Todd Lawson, Karen Brewington, Jeffrey James, David Baker, and Hugh Leahy. Also in attendance were Gina Jennings, Finance Director Appointee; and Michael Shone of Peirce Park Group, the County's Pension Investment Consultant. Committee member Lynda Messick was unable to attend.

On May 9, 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. Webb called the meeting to order and reviewed the agenda.

1. **Approval of Minutes**

The minutes of February 21, 2013 were approved by consent.

2. **Investment Analysis for the Quarter Ended March 31, 2013**

Mr. Shone distributed copies of a booklet entitled, "Sussex County Investment Performance Report, March 31, 2013". The report includes information regarding the market environment for the first quarter of 2013, as well as quarterly and annual performances of the Pension and OPEB Plans. Although the report should be referenced for a more detailed analysis, discussion highlights include:

Mr. Shone referred members to Market Environment – Economic Summary (Tab I). The U. S. stock market was up over 10 percent for the first quarter, and the U. S. economy grew during the same time period. Real gross domestic product increased 2.5 percent in Quarter 1 of 2013, compared to .4

percent during Quarter 4 of 2012. To stimulate the economy, low interest rates were continued by the Federal Reserve. Although the economy is improving, real personal consumption has remained level since 2010, and the rate of personal savings has decreased. To continue the same level of consumption, consumers have had to tap into their personal savings. Salaries will need to increase before any increase in consumer spending is realized.

The U. S. stock market was up 10.7 for the first quarter, and 13.9 percent for the year (April 1 to March 31). The OPEB Fund contains international stocks through Dodge & Cox and Harding Loevner. For the second consecutive quarter, internationals have not performed well.

When U. S. Markets are up, the Emerging Markets (Brazil, Russia, India, China, Eastern Europe, Latin America, and most of Asia and Africa) typically perform well, but this did not happen and resulted in a negative first quarter.

Fixed Income (which includes U. S. Bonds) was slightly negative for the quarter, which may be the trend for an extended period of time. High yield bonds (junk bonds – below investment grade) performed well.

Value stocks outperformed growth for the last quarter and fairly significantly for 2012. The County's portfolio is slightly tilted toward value stocks. Value stocks, historically, have better returns, offer less volatility, and typically are more protective in the down markets.

Mr. Shone directed members to the Pension Fund Performance Report (Tab II). The Pension Fund realized a first quarter gain of $3.4 million (net – of all investment management fees), or 5.8 percent; and had a one year gain of $4.3 million (net), or 9.3 percent. The Plan realized strong returns with very good protection in down markets. All managers, except Fidelity, outperformed their benchmark for the first quarter.

Although Mr. Shone does not recommend any changes to the Pension Fund at the current time, of concern is the County's actuarial assumption (8 percent rate of return) over the long-term. A change to the County's assumed rate of return could be accomplished incrementally. Peirce Park has 30 clients, of which Mr. Shone manages 13. The County has the most conservative portfolio of all his clients (60 percent stocks/40 percent bonds), which results in lower long-term returns. Taking into consideration the constraints contained within the County's Investment Policy, Mr. Leahy inquired if adjustments (i.e., duration or quality) could be made to the fixed

income portion of the portfolio to realize better returns. Mr. Shone noted recent changes were made to the County's portfolio to reflect a minimum investment (allocation mix) of 50 percent in government bonds, with no change in grade or duration. Regarding duration, longer term bonds are more adversely affected when interest rates increase. The revisions to Wilmington Trust's Investment Management Agreement were only recently implemented so any impact, or changes, would begin to be reflected in second quarter reports.

Discussion took place regarding the benefit of increasing the County's portfolio to 65 percent in equities. It was noted that the County's portfolio is rebalanced on a yearly basis and is typically done at the time of the annual contribution. Peirce Park does their reporting on a quarterly basis, which would, in fact, allow more timely adjustments/rebalancing of the County's portfolio if needed.

Withdrawals during the first quarter of 2013 were $49,829 for management fees, with an ending market value of $62,209,232 (Dupont Capital Investment - $10,083,992), Fidelity Low Price Stock - $4,097,760, Wilmington Trust Bonds - $7,238,008, Operating Account - $3,109,146, and State of Delaware Investment Pool - $37,680,325). The management fees of the County's Pension Fund are higher than Peirce Park's other clients. This is a result of the inclusion of private equities and hedge funds in the State Pool. Taking into consideration returns versus costs, State funds have realized greater returns for the majority of the time. Management investment fees for the County are .61 percent, with Peirce Park's lowest client at .23 percent, with an average of .35 to .43 percent.

The upside versus the downside capture ratio (a measure of how the fund has performed in up markets versus down markets) reflects that the County's Pension Fund has realized approximately 90 percent of its benchmarks.

Mr. James inquired as to the impact on returns due to the County's conservative investment approach. Mr. Shone confirmed that the County's conservativeness can have a negative impact on returns. In spite of the County's very conservative nature, the County's plan still ranked in the top 24 percent nationally (plans of all sizes). The State Plan is more aggressive than the remainder of the County's portfolio, but the County's overall risk versus reward remains very good.

Mr. Shone noted Peirce Park's satisfaction with Wilmington Trust, investment manager for the fixed income portion of the County's Pension and OPEB Plans, and reiterated their excellent performance.

Mr. Shone referred members to the OPEB Performance Report (Tab III). The OPEB Fund realized a first quarter gain of $1.35 million (net – of all investment management fees), or 5.1 percent; and had a one year gain of $1.8 million (net), or 7.1 percent. The lag in performance was due to the large cash allocation at the end of 2012.

Possible improvements for the OPEB Plan include changing the mandate for Harding Loevner (global equity manager) to internationals only and to rebalance domestic equity. Due to low interest rates, consideration may be given to decreasing the fixed income allocation and lowering the actuarial assumptions. The County is also currently underallocated in stocks.

Withdrawals during the first quarter of 2013 included $25,856 for investment management fees, with an ending market value of $27,638,534 and a time weighted return of 5.2 percent for the quarter, or 7.6 percent for 2012. The County's OPEB fund consistently performed under their benchmarks.

Although the County's OPEB realized only a 5.2 percent return, the fund still ranked above average nationally. Last quarter, international stocks significantly underperformed U. S. stocks, and emerging markets performed at an even lower level compared to the U. S. market. The County's OPEB fund has a lower allocation of internationals (12 percent) and emerging markets; the average public fund contains approximately 18 to 20 percent in internationals. Although the OPEB plan has made progress, improvements are needed.

Mr. Shone referred members to a separate handout showing the OPEB total fund value as of April 30, 2013. He briefly reviewed the market value of each fund by manager. The County's best performer was Vanguard Mid Cap Index, which was recently added; they are up 12.9 percent for the quarter and 14.8 year-to-date.

Needing to leave the meeting, Ms. Webb noted that she would like to briefly discuss a few items not directly related to the investment portfolio; namely, possible changes to the County's OPEB and Pension Plans.

3. **Possible Changes to OPEB Plan**

Due to the budget impact of the Pension Fund, Ms. Webb reported that starting with the 2014 budget, or, more specifically, effective January 1, 2014, the County will be implementing a Spousal Coordination of Benefits and a Birthday rule, as well as new dental and vision reimbursement plans.

The Spousal Coordination of Benefits requires an employee's spouse to take other medical coverage if it is available, and the Birthday Rule requires dependents to take primary coverage under the parent's insurance whose birthday comes first in the calendar year. These revisions are anticipated to reduce the County's healthcare costs in the budget and, possibly, reduce the contribution to the OPEB Plan.

4. **Possible Changes to Pension Plan**

Starting January 1, 2014, Ms. Webb reported that new hires will begin to contribute 3 percent of their salaries, after the first $6,000; this is similar to Kent and New Castle counties and other municipalities, as well as the State. Other possible changes may include revising the vesting requirement from 8 to 10 years, and a change in the retirement date from the age of 62 and 8 years of service to 65 and 10 years of service, as well as possibly lifting the service caps of 25 years for medics & dispatchers and 30 years for regular County employees.

Mr. Leahy noted the benefit of packaging the changes mentioned by Ms. Webb along with a possible change to the assumed rate of return. Mr. James stated his concern regarding lower salaried County employees and their ability to make pension contributions; he stated his preference for a defined benefit plan versus a defined contribution. With any pension discussion, Mr. Lawson noted salaries also need to be considered. In light of recent medical and pension changes, in combination with lower County salaries, Ms. Webb expressed concern in wanting the County to remain competitive as an employer.

Before leaving the meeting, Mr. Lawson recognized Ms. Webb for her 20 years of service to the County. Ms. Webb will be retiring on May 24, 2013.

3. **Possible Changes to OPEB Plan – Continued Discussion**

Mr. Shone referred members to a separate handout entitled, Sussex County – OPEB Rebalancing Options, dated May 16, 2013. Mr. Shone reiterated that while definite improvement has been seen in the structure of the OPEB Fund, improvements need to be considered. The following three options were discussed and reviewed (portfolio allocation mixes); options are 'not' listed in any order of preference:

Option 1: Hire international manager, terminate BlackRock, and convert Harding Loevner to international

Option 2: Hire domestic large-cap growth manager, convert Harding Loevner to international, and convert Dodge & Cox to international

Option 3: Hire domestic large-cap growth manager, hire international manager, and convert Harding Loevner to international

Mr. Shone also reviewed an additional recommendation that he hoped would expedite the process by eliminating the need for Peirce Park to make more specific international and growth manager recommendations, as well as the need for County Council approval. It was noted that County Council approval would still be required. Below are the current percentages, along with the recommended changes:

	Current	Recommended Option
BlackRock Equity Dividend	4.0	4
Vanguard Dividend Growth	4.1	6
Vanguard Russell 1000 Index	16.5	24
Vanguard Mid Cap Index	6.1	5
Ridgeworth Small Cap Index	5.3	5
Dodge & Cox Global	9.4	8
Harding Loevner Global Equity	12.8	-
Wilmington Trust Fixed Income	33.3	35
Cash & Equivalents	8.6	5
Harding Loevner Int'l Equity	-	8
Estimated Total Management Fees	0.38%	0.33%

Committee members noted their agreement with Mr. Shone's additional recommendation.

A Motion was made by Mr. Lawson, seconded by Mr. Baker, to approve the recommendation by Mr. Shone and make recommendation to the Sussex County Council for the following OPEB portfolio allocation mixes: BlackRock Equity Dividend – 4 percent, Vanguard Dividend Growth – 6 percent, Vanguard Russell 1000 Index – 24 percent, Vanguard Mid Cap Index – 5 percent, Ridgeworth Small Cap Value – 5 percent, Dodge & Cox

Global – 8 percent, Harding Loevner Global Equity – none, Wilmington Trust Fixed Income – 35 percent; Cash & Equivalents – 5 percent, and Harding Loevner International Equity – 8 percent. Motion Adopted by Voice Vote.

Due to the Memorial Day Holiday, it was noted that action by Council could not take place until the June 4, 2013 meeting at the earliest. Mr. Shone will prepare the recommendation and rationale for such action for presentation to Council.

5. **Additional Business**

a. Mr. James noted the invaluable information provided by Mr. Shone, as well as his overall pleasure with the services offered to the County by Peirce Park.

b. Mr. Leahy stated that he did not want the Committee to lose sight of the assumed rate of return. Mr. Baker and Mr. Lawson noted their agreement with Mr. Leahy's previous recommendation to package the benefit changes reported earlier by Ms. Webb, along with a possible modification to the 8 percent rate of return used by the County's actuary.

c. Mr. Lawson congratulated Mr. Leahy on his upcoming June retirement from the Delaware Community Foundation and noted that the bylaws of the Pension Committee do not prohibit his serving on the Committee after his retirement.

At 11:17 a.m., a Motion was made by Mr. Lawson, seconded by Mr. Leahy, to adjourn. Motion Adopted by Voice Vote.

Mr. Lawson thanked everyone for their attendance.

Respectfully submitted,

Nancy J. Cordrey
Administrative Secretary