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PENSION FUND COMMITTEE

Minutes of Meeting

May 22, 2014

The Sussex County Pension Fund Committee met on May 22, 2014, 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, Hugh Leahy, and Kit Ryan. Also in attendance was Michael Shone of Peirce Park Group, the County's Pension Investment Consultant.

On March 14, 2014, the Agenda for today's meeting was posted in the County's locked bulletin board located in the lobby of the County Administrative Office, as well as posted on the County's website.

Ms. Jennings called the meeting to order.

1. **Approval of Minutes**

   The minutes of the February 20, 2014 meeting were approved by consent.

2. **Welcome New Pension Committee Member**

   Ms. Jennings welcomed newly appointed member Kathleen (Kit) Ryan. Ms. Ryan is a certified financial planner and is the President of KMR Financial Network in Georgetown. Ms. Ryan was approved by the Sussex County Council at their May 6, 2014 meeting to replace Ms. Lynda Messick (community member) whose term was set to expire January 2016.

3. **Investment Analysis for the Quarter Ended March 31, 2014**

   Mr. Shone distributed copies of a booklet entitled, "Sussex County Investment Performance Report, March 31, 2014". The report includes information regarding the market environment for the first quarter of 2014, 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 – 1st Quarter of 2014 (Tab 1). He noted that the Pension Plan had experienced an exceptional quarter, with the one, three and five-year periods having good returns as well. Due to changes implemented to the OPEB Plan in mid to late January, those returns have outperformed the Pension Fund.

The economy is moving along very positively, but at a relatively slow pace due to concerns as to events in Russia and its impact on Europe, as well as the United States. During the first quarter of 2014, interest rates decreased, and the Fed lowered its bond purchases resulting in decreased yields on long-term treasuries. Light vehicle sales (cars and small trucks) have steadily increased since 2009. For the past year, U. S. Equities were up 22.6 percent and realized a positive first quarter of 2.0 percent. Since the end of February, International Equities have significantly outperformed U. S. Equities, and Emerging Markets performed significantly worse. In comparison, the Pension Plan has a higher allocation in Emerging Markets than does the OPEB Fund due to the State. It had been a very good first quarter for fixed income, with bonds up 1.8 percent. Inflation sensitive investments reversed course from a disappointing 2013; U. S. REITs (real estate investment trusts) posted strong returns in quarter one, benefitting from the decline in interest rates. The U. S. Equity Markets posted a positive quarter; Mid Cap Value were the best performers; and Value stocks outperformed Growth for the first quarter. The County's OPEB Fund has a slight tilt toward Value and Mid Cap stocks. Impacting U. S. Treasury Yields, interest rates rose significantly from March to December 2013.

Mr. Shone referred members to the Pension Fund Performance Report (Tab II).

Observations for the Sussex County Pension Fund:

- The Pension Fund realized a first quarter gain of $1.69 million (net of all investment management fees); a one year gain of $8.5 million (net); a first quarter return of 2.5 percent (gross); and one year return of 14.3 percent (gross).

- Very strong performance/returns

  - DuPont Capital – strong returns for the first quarter, as well as years 1 and 3

- State (private equity/venture capital and hedge funds had a very strong first quarter performance – 19.5 percent of their portfolio; with fixed income at 25 percent of portfolio).

  Mr. Shone noted that almost 20 percent of the State's monies is in private equity/venture capital and hedge funds; 60 percent of the County's money is with the State. The County's IPS calls for 60 percent equities and 40 percent fixed income. Although the State has similar benchmarks, those targets are presently closer to 75/25, which results in the County having a higher equity allocation (65 percent). The State's plan is more aggressively managed than the County's.

- Fidelity – had a very good quarter; typically does better in down markets, not as well in up markets

Looking Ahead

- Need to adjust IPS (Investment Policy Statement) and policy index to reflect cash
- Cash flow management – can the County make monthly ARC contributions?

Discussion was held regarding the Pension Fund's $3.6 million in cash (Wilmington Trust Short Term Bond). These funds cover the actual pension costs for the year that are paid out in June. Mr. Shone also discussed the possibility of monthly ARC contributions instead of on a one-time yearly basis. Mr. Shone noted if, operationally, a yearly contribution is preferred, he would like the Investment Policy Statement to reflect that a portion of the fixed income is to include cash (a target of 2 or 3 percent).

The ending market value of the Sussex County Pension Plan as of March 31, 2014 was $71,322,869, which included DuPont Capital Investment - $12,493,746, Fidelity Low Price Stock - $5,087,141, Operating Account - $194,098, State of Delaware Investment Pool - $42,793,005, Wilmington Trust Bonds - $7,166,931, and Wilmington Trust Short Term - $3,587,947.

As of March 31, 2014, Sussex County's Pension Asset Allocation included: State of Delaware Investment Pool – 60.0 percent; Cash – .3 percent; Domestic Fixed income – 15.1 percent; and Domestic Equity – 24.6 percent.

For the first quarter of 2014, the County's Pension Fund was up 2.5 percent and ranked in the top 3 percent nationwide (out of approximately 200 public plans), 15 percent for the year, 25 percent for two years, and in the top 26 percent for the past three years. The average Peirce Park plan is more aggressively invested in equities. Since its inception in January 2009, the County's Pension Plan has realized an average return of 12 percent per year. Due to the rate of growth over the next 5 to 10 years, Mr. Shone feels the County will find it difficult to realize returns of 7.5 percent, which is the County's assumed investment rate of return.

Over the past three years, the total Pension Fund realized returns of 9.4 percent, the State of Delaware - 9.2 percent, DuPont Capital – 15.8 percent, Fidelity – 16.1 percent, and Wilmington Trust Bonds – 2.5 percent. For the first quarter, the County realized returns of 2.5 percent versus 3 percent for the State.

Mr. Shone reported that the County's overall Investment Management Fee of .56 percent is much higher than Peirce Park's other clients. The County's higher fees are a result of the State's expense ratios for their private equities and hedge funds.

Ms. Ryan noted that Fidelity also has very high management fees. She inquired as to the County's contract with Fidelity and if index funds had been considered in place of small cap. Although index funds would offer lower fees, Fidelity typically performs better in down markets. It was noted that the County does have the option of discontinuing its relationship with Fidelity, as a manager, at any time. After discussion, it was the consensus of the Committee for Mr. Shone to report back at the next meeting as to the tradeoff between small cap and index funds, as well as their expected return.

Mr. Shone referred members to a separate handout regarding the total Pension Fund composite as of April 30, 2014. The total fund increased by an additional .3 percent for a total year-to-date of 2.8 percent. Although down (-1.1), Fidelity was down significantly less than their index (-3.9).

Mr. Shone referred members to the OPEB Fund Performance Report (Tab III). The OPEB Fund realized a first quarter gain of $176,000 (net of all investment management fees); a one year gain of $2.89 million (net); a first quarter return of .6 percent (gross); and a one-year return of 11.3 percent (gross).

Mr. Shone noted that portfolio changes were implemented in mid-January; as a result, February and March realized returns of 3.0 percent. Hindrances on performance include large cash holdings, prechange returns, and Wilmington Trust trades.

Mr. Shone noted that the following items should be considered by the Committee: Cash Flow Management (can the County make ARC payments on a monthly basis instead of once a year?), as well as the Investment Policy Statement. Currently, the County has a target of 12 percent in international equities, but Mr. Shone has made the recommendation to increase this target to 14 percent.

The ending market value of the OPEB Fund as of March 31, 2014, was $31,198,313.

As of March 31, 2014, Sussex County's OPEB's Asset Allocation included: Domestic Equity – 44.4 percent; Global Equity – 3.5 percent; International Equity – 12.0 percent; and Domestic Fixed Income – 40.1 percent; all are within their targets.

Mr. Shone noted that the rankings for the OPEB Plan are not as desired and was the impetus behind the County's recent changes.

Mr. Shone referred members to a separate two-page handout for the OPEB Trust. For the period February 1 through April 30, 2014, the OPEB Fund realized a 3.4 percent return, with an ending market value of $31,325,657. A Mutual Fund Performance Summary – through May 16, 2014 – was also included.

The report also includes a detailed summary of the actual holdings within both the Pension and OPEB Plans. The County has a separate contract with Wilmington Trust, which contains investment guidelines.

Wilmington Trust's fixed income bonds include treasuries, government agency bonds, and corporates (short term duration). In remaining with very high credit quality investments, the tradeoff is lower returns. After discussion by the Committee regarding the possibility of taking on more risk to realize higher returns, Mr. Shone report will back to the Committee – from an educational perspective – regarding the types of investments available for the County's consideration.

4. **Employee Pension Plan – Investment Policy Statement (IPS)**

Ms. Jennings reported that the Investment Policy Statement for the Employee Pension Plan had not been updated since 2007. The proposed changes include grammatical corrections, clarification, updated language to reflect industry standards, and to bring the document more in line with the OPEB Investment Policy Statement (amended in 2012).

Mr. Shone briefly reviewed the recommended revisions, which included: "Standard of Care" provisions to include Prudence, Ethics, Delegation of Authority, and Responsibilities of the Committee and Staff. In essence, the IPS now states that the County has delegated authority to the Investment Managers (State of Delaware, DuPont, and other mutual fund companies) to select individual securities. The asset allocations and targets are now included as Attachment 1. Attachment 1 now also includes an allocation for 'cash'. Investment targets remain the same: 60 percent equities/40 percent fixed income.

Mr. Leahy inquired as to the overall intention of the investment policy regarding its target allocation of 60 percent equities/40 percent fixed income and the need for clarification to be contained in the IPS. After discussion, it was the consensus of the Committee for Mr. Shone to prepare the appropriate wording to be included in Attachment 1 to reflect these targets.

A Motion was made by Mr. Leahy, seconded by Mr. Baker, that the Sussex County Pension Fund Committee recommend to the Sussex County Council to adopt the Investment Policy Statement for the Sussex County, Delaware Employee Pension Plan, with the recommended changes as presented by Mr. Shone, including the additional clarification in Attachment 1 as to the overall intent for a 60 percent equities and 40 percent fixed income asset allocation mix.

Motion Adopted:	7 Yea.
Vote by Roll Call:	Mr. James, Yea; Ms. Brewington, Yea; Ms. Ryan, Yea; Mr. Leahy, Yea; Mr. Baker, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

5. **Additional Business**

Mr. Leahy inquired as to the timeframe in which new financial reporting guidelines go into effect. Ms. Jennings noted that the changes will take effect with Fiscal 2014 for the Pension Fund and 2017 for the OPEB. Ms. Jennings is currently working with the County's actuary regarding these changes and plans to bring the actuary's report to the Pension Committee at the meeting in August. The report will include the new assumptions that have been put in place and their impact, including improvements realized to the overall funding level of the Pension and OPEB Plans. Mr. Shone reiterated that the County has the best funded pension plan of all his clients and, categorically, the best funded for the OPEB.

Mr. Leahy expressed concern regarding how the funding levels for the Pension and OPEB Plans are relayed to the public and their interpretation if the Plans are not 100 percent funded.

Ms. Jennings reported that a proposed pension contribution of $5.3 million is included in the Fiscal 2015 Budget, which is above the required contribution of slightly less than $5 million. Due to the recent assumption changes, the actual required contribution has decreased.

Ms. Jennings thanked everyone for their attendance.

At 11:21 a.m., a Motion was made by Mr. Lawson, seconded by Mr. Baker, to adjourn.

Motion Adopted:	7 Yea.
Vote by Roll Call:	Mr. James, Yea; Ms. Brewington, Yea; Ms. Ryan, Yea; Mr. Leahy, Yea; Mr. Baker, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

Respectfully submitted,

Nancy Cordrey

Nancy J. Cordrey
Administrative Secretary