GINA A. JENNINGS, MBA, MPA
FINANCE DIRECTOR
(302) 855-7741 T
(302) 855-7749 F
gjennings@sussexcountyde.gov

Sussex County
DELAWARE
sussexcountyde.gov

PENSION FUND COMMITTEE

Minutes of Meeting

November 17, 2016

The Sussex County Pension Fund Committee met on November 17, 2016, at 10:00 a.m. in the County Council Chambers, Georgetown, Delaware. Those in attendance included members: Gina Jennings, Kathy Roth, David Baker, and Kathleen Ryan. Also in attendance were Michael Shone of Peirce Park Group, the County's Pension Investment Consultant; and Janet Cranna, Margaret Tempkin, and Brett Warren, of Cheiron, the County's Actuary. Committee members Hugh Leahy, Todd Lawson, and Karen Brewington were unable to attend.

On November 9, 2016, the Agenda for today's meeting was posted in the County's locked bulletin board located in the lobby of the County Administrative Offices, as well as posted on the County's website. Committee members were presented with a booklet containing information for today's meeting.

Ms. Jennings called the meeting to order.

1. **Approval of Minutes**

The minutes of the August 18, 2016 and September 16, 2016 meetings were approved by consent.

2. **Annual Actuarial Report**

At the request of the County, Cheiron, the County's actuary, performed an actuarial valuation of the Sussex County Employee Pension Plan as of July 1, 2016. In their valuation, they presented an Executive Summary, which contained their key results; the main portion of their report detailed the Plan's Assets, Liabilities, and Contributions. Calculations under GASB 67 and 68 were provided under a separate report. Cheiron noted that the purpose of the actuarial valuation was to identify the financial condition of the Plan, expected trends in the financial progress of the Plan, and the County's contributions for Fiscal Year ending 2017.

Committee members were provided with three reports, "Sussex County Employee Pension Plan – Actuarial Valuation Report as of July 1, 2016", "Sussex County Pension Plan – GASB 67/68 Report as of June 30, 2016 Measurement Date", and "Sussex County Other Postemployment Benefits Actuarial Valuation Report as of July 1, 2016; copies of the Pension Plan PowerPoint were also made available.

PENSION PLAN:

(1) *Historical Review* – includes participation/participant trends, assets and liabilities, and contributions

Participant Trends – The ratio of participant trends has been decreasing since 2011 – from 2.0 percent in 2011 to 1.5 percent in 2016, which is a sign of plan maturity. The active population has remained relatively stable from last year; the average salary has increased 2.6 percent ($45,433); the in-pay counts have increased 5.6 percent (227); the average benefits rose 3.3 percent ($15,919); and the number of terminated vested count saw an increase of 3.8 percent (83).

Assets and Liabilities – the Plan's funded ratio has fluctuated, but has generally declined since 2011. In 2015, the market value and the actuarial value of assets are equal due to the resetting of the actuarial value primarily due to GASB, with smoothing begun again in 2016. The actuarial funded ratio for the Pension Plan decreased from 84.2 percent to 83.4 percent funded, with a market funded ratio decreasing from 84.2 percent to 78.4 percent;

Contributions - For the first time, the Actuarial Determined Contribution (ADC) for Fiscal 2017 includes an administrative expense assumption that was adopted by the County. It was noted that from 2012 to 2016, the County has consistently paid more than the ADC. The County's contribution, as a percentage of payroll, increased from 14.50 percent ($3,057,193) to 15.65 percent ($3,391,726).

(2) *Valuation Results*

- The actuarially determined County contribution increased from $3.06 million payable as of July 1, 2015 to $3.39 million payable as of July 1, 2016; this was, primarily, due to an increase in the amortization payment, as well as anticipated administrative expenses.
- The unfunded actuarial liability (the difference between the actuarial value of assets and the actuarial liability) increased from $14.0 million on July 1, 2015 to $15.7 million on July 1, 2016;
- There was an actuarial experience liability loss of $0.1 million;
- The Plan's funding ratio, the ratio of actuarial asset value over liabilities, decreased from 84.2 percent as of July 1, 2015 to 83.4 percent as of July 1, 2016;
- The main factor in the decline of the Plan's funded status was an actuarial experience loss of $1.2 million. In addition, there was an increase of $1.0 million in the actuarial liability related to programming and software differences from the prior actuary.

(3) *Projected Outlook*

Cheiron's analysis presented projected financial trends and demonstrated the expected progress of the County's funded status over the next 20 years in terms of the expected employer contribution rates, the total dollar amounts of contributions, and the funding ratio. For each projection, three future investment return scenarios were assumed: (1) baseline returns of 7.50

percent, (2) optimistic returns of 9.0 percent, and (3) pessimistic returns of 6.0 percent. The projections assume there will be no future gains or losses on the liability and that the valuation of assumptions are exactly met, including the long-term rate of return assumed for each scenario, with covered payroll increasing by the inflation assumption of 2.5 percent per year in all three scenarios presented:

Baseline Returns of 7.5 Percent – If all actuarial assumptions are exactly met, including the rate of return assumption, the actuarially determined employer contribution rate will slowly decline from 15.7 percent to 12.9 percent of pay and the total dollar contribution increases from $3.4 million to $4.4 million by Fiscal Year Ending (FYE) 2035 when the Unfunded Actuarial Liability (UAL) is fully paid off.

Optimistic Returns of 9.00 Percent – If the Plan earns 1.50 percent greater than the assumed rate in each year of projection, the actuarially determined contribution rate will rapidly decrease and eventually reach 0.0 percent in FYE 2032. In FYE 2032, and all future years, the investment gains would cover all of the employer normal cost (including administrative expenses).

Pessimistic Returns of 6.00 Percent – If the Plan earns 1.5 percent less than the assumed rate in each year of the projections, the actuarially determined contribution rate will rapidly increase in the final years of the 2-year closed period to about 38.1 percent, and the total dollar contribution will increase to $12.9 million by FYE 2035. In FYE 2036, the initial 20-year closed layer UAL is fully paid off,

GASB 67 – The County first adopted GASB 67 in the June 30, 2014 financial statements. Projections indicate that plan assets are expected to cover all future benefit payments for current plan members. Results presented reflect the change in net pension liability, sensitivity of net pension liability to changes in discount rate (6.50 percent, 7.50 percent, and 8.50 percent), and the schedule of employer contributions (comparing the actuarially determined contribution versus what the County is actually contributing to the plan). Under GASB 68, the pension expense is equal to the change in the plan's net pension liability (NPL), with adjustments for deferrals. Treatment of deferrals include asset gains or losses recognized over 5 years, liability gains or losses and assumption changes recognized over the average future working lifetime (6 years for the Plan), no deferral on plan changes, and deferred gains (deferred inflows) and losses (deferred outflows.

OPEB PLAN – Cheiron, at the request of the County, also performed an actuarial evaluation of the postemployment benefits provided by the Sussex County Postemployment Benefit Plan as of July 1, 2016 for the fiscal year July 1, 2016 through June 30, 2017. Their report contains their findings and disclosures required by the Governmental Accounting Standards Board (GASB) standards (Note: copies of the OPEB PowerPoint were made available via email the following day). The format was similar to the Pension Plan – Historical Review, Valuation Results, and Projected Outlook, as well as GASB 74/75 information/estimates for 2017.

(1) *Historical Review* – included participants trends, assets and liabilities, as well as contributions

Participant Trends – slight increase from 465 to 482 employees (3.66 increase); retirees increased from 135 to 148 (9.63 percent increase), and those disabled remained the same (14).

Assets and Liabilities – The increase in liability from January 1, 2015 to July 1, 2016 is primarily due to the change in funding method from Projected Unit Credit funding to Entry Age Normal funding. Currently, the OPEB Plan is 65 percent funded.

Contributions – The County has been very fiscally responsible and has made their ARC plus, which reflects their 65 percent funding; many other plans are only 15 percent funded.

(2) *Valuation Results*

Actuarial Liability (AL)

- Funding method changed from Projected Unit Credit (PUC) to Entry Age Normal (EAN)
- Actuarial Liability (AL) increased from $41.2 million to $48.8 million
- AL was expected to increase to $44.6 million under PUC method
  - Funding method from PUC to EAN increased the AL an additional $5.8 million to $50.4 million
- Decrease in AL of $2.4 million due to:
  - Updated claim curves – favorable claims experience
  - Changes in trends – extended trends over longer period, plus split between pre-Medicare and Medicare
  - Demographics – population changes
  - Assumption changes – small assumption change on amount provided to surviving spouses
  - Change in valuation date from 12/31 to 6/30
- Increase in AL due to programming and software differences from the prior actuary of $0.8 million
- Unfunded actuarial liability (UAL) and funded status
  - UAL increased from $10.9 million to $17.0 million
  - UAL expected to increase to $17.5 million under EAN method
  - Actuarial experience asset loss of $1.1 million
    - 1.8 percent asset return compared to a 7.5 percent expected return
  - Actuarial experience liability gain of $1.6 million
    - Healthcare claim curves updated and trends extended
    - Programming and software changes between actuaries
  - Funded ratio decreased from 73 percent to 65 percent (primarily due to change to Entry Age Normal)
- Contributions

- Annual Required Contribution (ARC) increased $1.86 million to $1.87 million
    - FYE 2017 ARC includes the change to entry age normal in preparation of GASB 74/75

(3) *Projected Outlook*

Baseline – projected assumptions: 7.5 percent discount rate, ARC contributions, 30-year open amortization, and will eventually fail crossover test under GASB 74/75 forcing lower discount rate in the future

Budgeted Contributions – two project assumptions were presented:

7.5 discount rate: budgeted contributions of 9.50 percent of pay, 30-year open amortization, will not fail crossover test, and assets projected to grow to cover 98 percent of expected liabilities by 2036

7.25 discount rate (anticipated change for 2017): budgeted contributions of 9.50 percent of pay, 30-year open amortization, will not fail crossover test, and assets projected to grow to cover 90 percent of expected liabilities by 2036

GASB 74/75 (does not come into effect until 2017) – GASB has adopted new statements for OPEB similar to GASB 67/68 pension statements; employer reporting for the County will first occur as of the June 20, 2018 reporting date; GASB 74/75 requires using market value of assets, which is already done; will have to show the results of sensitivity (1 percent discount rate change and a one percent change in healthcare trends); and treatment of deferrals; Cheiron also included estimated results (OPEB liability $17 million, a net change of $5,091). Under GASB 75, the OPEB expense is equal to the change in the Plan's Net OPEB Liability (NOL), with adjustment for deferrals. Treatment of deferrals include asset gains or losses recognized over 5 years, liability gains or losses and assumption changes recognized over average future working lifetime, no deferrals on plan changes, and deferred gains called "deferred inflows' and deferred losses called 'deferred outflows'.

The Committee thanked Ms. Cranna, Ms. Tempkin, and Mr. Warren for their presentation.

3. **Review Funding Policies**

The Committee was provided with copies of proposed funding policies for both the Pension and OPEB Plans. The Government Finance Officers Association (GFOA) recommends every local government that offers defined benefit pensions formally adopt a funding that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner. Ms. Jennings noted that the objectives of both policies are to:

1. provide sufficient assets to permit the payment of all benefits under the Trust;
2. maintain equity among generations of taxpayers;
3. improve the Trust's funded ratio; and
4. minimize the volatility of the employer's annual contribution

As suggested at August's meeting, Cheiron provided language for both plans regarding the ADC (Actuarially Determined Contribution) and how it will be calculated. Upon the committee's recommendation, the funding policies would be taken to County Council for their approval and adoption. Brief discussion was held regarding the changes.

A Motion was made by Ms. Ryan, seconded by Mr. Baker, that the Pension Committee recommend adoption by the Sussex County Council of the Pension funding policy as presented.

Motion Adopted: 4 Yeas.

Vote by Roll Call: Ms. Roth, Yea; Mr. Baker, Yea; Ms. Ryan, Yea;
Ms. Jennings, Yea

For the OPEB funding policy, Ms. Jennings discussed a proposed change to the funding guidelines on page 2 regarding the minimum contribution rate.

A Motion was made by Mr. Baker, seconded by Ms. Ryan, that the Pension Committee recommend adoption by the Sussex County Council of the OPEB funding policy as presented, with the clarification, under D. Funding Guidelines, 1. Minimum Contribution Rate: "The County will contribute at least 9.50 percent of pay and it will be at least the actuarially determined contribution (ADC) as calculated by the Trust's actuary".

Motion Adopted: 4 Yeas.

Vote by Roll Call: Ms. Roth, Yea; Mr. Baker, Yea; Ms. Ryan, Yea;
Ms. Jennings, Yea

The Committee, again, expressed appreciation to Cheiron.

4. **<u>Performance Reports of the Pension and OPEB Funds</u>**

Mr. Shone distributed copies of a booklet entitled, "Sussex County Investment Performance Report, September 30, 2016". The Investment Performance Report includes information regarding the market environment for the third quarter of 2016, 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 <u>Market Environment – 3rd Quarter of 2016</u> (Tab 1).

Mr. Shone expressed his agreement with the County lowering its assumed rate of return from 7.50 percent to 7.25 percent and to expect lower than historic returns over the next ten years.

The third quarter saw the real Gross Domestic Product (GDP) expand 2.9 percent, which was the strongest quarterly growth in more than two years. The Federal Reserve is expected to raise interest rates in December given the steady labor market and increasing wage growth. The equity market realized strong gains in the third quarter: U.S. equities: 4.4 percent for the quarter and 8.2 percent year-to-date, international equities: 6.3 percent for the quarter and 3.1 percent year-to-date, emerging market equities: 9.0 percent for the quarter and 16.0 percent for the year-to-date. Fixed income performed well: U. S. Bonds: 0.5 percent for the quarter (5.8 percent year-to-date); high yield bonds: 5.6 percent for the quarter (15.1 percent year-to-date), international bonds: 0.5 percent for the quarter (14.5 percent year-to-date), and Emerging Market Bonds: 2.3 percent for the quarter (17.6 percent year-to-date). Inflation sensitive assets, such as U.S. REITS, were up significantly (12. 3 percent) for the year.

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

As of September 30, 2016, the ending market value of the Pension Plan was $76.4 million and realized a third quarter investment gain of $2.5 million, as well as a 1-year gain of $5.8 million. The Pension Plan outperformed its policy index due to small and mid-cap index, underperformed the index by 240 basis points over the past year (primarily due to the Delaware State pool, although DuPont also underperformed), and the expense ratio continued to decrease. Looking ahead: portfolio changes in October 2016 (liquidated $8.8 million from the State of Delaware Investment Pool, target was lowered from 60 percent to 50 percent), added Vanguard S&P Index & Vanguard Total International Stock Index, and increased allocation to Vanguard Mid Cap Value, Extended Market Index & Wilmington Trust Fixed income), address the County's Pension Plan funding policy, and transfer funds from Vanguard to Wilmington Trust to consolidate custodians.

The ending market value of $76,473,231 included: DuPont Capital Investment: $14,990,765, Operating Account: $138,449, State of Delaware Investment Pool: $46,988,152, Vanguard Extended Market Index: $3,090,999, Vanguard Mid Cap Value: $2,722,778, Wilmington Trust Bonds: $8,542,089, and Wilmington Trust Short Term: $0. Over the last 3 years, the pension fund saw an investment gain of $13,645,374 million, or a 6.2 percent return.

As of September 30, 2016, Sussex County's Pension Asset Allocation included: State of Delaware Investment Pool: 61.4 percent; Cash: 0.2 percent; Domestic Fixed Income: 11.2 percent; and Domestic Equity: 27.2 percent.

Mr. Shone reiterated that, historically, Peirce Park has reported gross rates of returns (before investment management fees); currently, they are providing both gross and net, with the intent to report only net returns.

Over the last 5 years, the Pension Fund realized a 8.2 percent return and ranked in the top 45th percentile nationwide (out of 250 public funds); 6.2 percent return for 3 years (top 27th percent); and 1 year: 7.8 percent (88th percentile). For the quarter, the fund realized a return of 3.3 percent (57th percent).

The investment manager returns for the quarter: DuPont Capital Investment: 4.0 percent return versus benchmark of 3.9; Vanguard Extended Market Index (added October 2014): 7.3 percent (vs. 7.2 percent); Vanguard Mid Cap Value (added December 2014): 5.7 percent (vs. 5.7 percent); Wilmington Trust Bonds: 0.1 percent (vs. 0.2 percent); and State of Delaware Investment Pool: 3.3 percent versus a 3.4 percent benchmark.

Mr. Shone referred members to the OPEB Fund Performance Report (Tab III).

As of September 30, 2016, the ending market value of the OPEB Plan was $32.8 million and realized a third quarter gain of $877,000; and a 1-year gain of $2.8 million. The OPEB Plan lagged behind its policy index in the third quarter primarily due to MFS Low Volatility Global. Manager changes were made during the quarter: terminated Thornburg Global Opportunities and proceeds were split between Vanguard Institutional Index and Total International Stock Index. Looking ahead: address the County's OPEB funding policy and possible further diversification on the equity side.

It was the consensus of the committee for Mr. Shone to present recommendations for additional diversification (equity) at the February 2017 meeting.

Ms. Jennings thanked Mr. Shone for his presentation.

5. **2017 Meeting Dates**

Discussion was held regarding the meetings for 2017. Following are the meetings for 2017:

February 16, 2017
May 18, 2017
August 17, 2017
November 16, 2017

All meetings begin at 10:00 a.m. and are held in the Sussex County Council Chambers, Administrative Office Building, Georgetown, Delaware.

6. **Additional Information**

No Additional Business.

7. **Adjourn**

At 11:23 a.m., a Motion was made by Ms. Roth, seconded by Ms. Ryan, to adjourn.

Motion Adopted: 4 Yeas.

Vote by Roll Call: Ms. Roth, Yea; Mr. Baker, Yea; Ms. Ryan, Yea;
Ms. Jennings, Yea

Respectfully submitted,

Nancy J. Cordrey
Administrative Secretary