



# PENSION FUND COMMITTEE

## AGENDAS & MINUTES

### PENSION FUND COMMITTEE

#### *Minutes of Meeting*

*November 14, 2011*

The Sussex County Pension Fund Committee met on November 14, 2011, at 1:00 p.m. in the County Council Chambers, Georgetown, Delaware. Those in attendance included members: Susan Webb (Finance Director), David Baker (County Administrator), Karen Brewington (Director of Human Resources), and Councilwoman Joan Deaver, as well as Jeff James (Director of Engineering Accounting). Michael Shone of Peirce Park Group, the County's Investment Consultant, was also in attendance. On November 4, 2011, 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.

Ms. Webb reviewed today's agenda and introduced Mr. Shone.

#### **Annual Analysis of Investments for Pension and OPEB Plans**

Mr. Shone distributed copies of the "Sussex County Investment Performance Report as of September 30, 2011", 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 2011. Although the report should be referenced for a more detailed analysis, highlights discussed included:

- (a) Market Environment – 3<sup>rd</sup> Quarter (Page 1) – Mr. Shone noted that the global stock markets declined every month for the third quarter of 2011. It is important to note that key factors resulting in this volatility included the downgrade of U. S. Treasuries by Standard & Poor's, as well as the European debt problems that occurred in July. Standard & Poor's (S & P) is one of three credit rating agencies, which also includes Moody's Investor Services and Fitch Ratings. Although S & P was the only credit rating agency that downgraded U. S. Treasuries, this act alone was enough to throw the stock market into extreme turmoil during the last quarter. Although U. S. stocks were down, they did not decrease as much as international stocks. Mr. Shone explained that international stocks tend to perform better in up markets, and U. S. stocks generally perform better in down markets.

Page 3 - At the end of June 2011, a 30-year U. S. Treasury had a yield of 4.5 percent, with a yield of 3 percent by the end of September 2011. When interest rates go down, bond values go up. Although U. S. Treasuries performed very well this past quarter, Mr. Shone noted that when interest rates go back up, long-term bonds are the most adversely affected. At the end of June, short-term treasuries gave almost no interest return.

Currency returns relative to the U. S. dollar show that the dollar outperformed most other currencies, with the exception of the Japanese yen. When the dollar is strong, U. S. Stocks generally perform better, but the opposite is true when the dollar declines.

Page 4 – All types of U. S. stocks (large cap, large growth, large value, mid-cap, mid-growth, mid-value, small cap, small growth and small value) had a negative rate of return for the third quarter in 2011. Small cap stocks experienced the worst returns for the quarter. The smaller the company, the more adversely affected when the economy declines.

Page 5 – Of all the international equities, Greece performed the worst. The County's portfolio is diversified and contains both U. S. and non-U.S. stocks; large, mid size, and small company stocks; value stocks and growth stocks. Value stocks (utilities, energies, financials) tend to have a lower price-to-earnings, and growth stocks (healthcare, technology) have lower dividends.

Page 6 – Long-term U. S. Treasuries, of 20+ years, were up 29 percent for the third quarter of 2011.

From a planning perspective for the County's pension fund, Mr. Shone noted that the great difficulty facing the County is in the actuarial assumption rate of 8 percent. The actuary must look long-term regarding the County's ability to meet future benefit payment projections. He stated that if bonds do not perform well, one of two things have to occur: stocks have to perform better than average, or a reduction in the actuarial assumption rate is needed. It was explained that if the actuarial assumption rate is decreased, the County will have to increase their annual contribution. When questioned, Mr. Shone stated that an 8 percent actuarial assumption is typically the highest seen. Of Peirce Park Group's clients, which includes counties and municipalities (cities, towns, and boroughs), counties typically have an assumption rate of 7.5 percent, with a rate of 8 percent for municipalities.

- (b) Tab 1 – Pension Fund (Page 9 – Highlights) – For the third quarter of 2011, the County's Pension Fund was down 6.6 percent; for the year (October 1 to September 30), the fund was up 4.7 percent; and up 5.8 percent for the past three years. In comparison with other government pension funds, Mr. Shone stated that the County's plan was in the top 25 percent for the quarter, year-to-date, as well

as for one, two, and three year periods. For the past year, the County's plan was in the top 8 percent nationwide. The State Pool performed extremely well and helped the County realize such positive results, as did the performance of the plan managers. The State fund is well diversified and is more aggressive than the County's conservative approach. At times, the State Pool has been 75 percent funded in stocks whereas the County has a 60/40 ratio – 60 percent stocks and 40 percent bonds. The County can also have up to 25 percent of their portfolio invested in corporate bonds. Corporate bonds have underperformed treasuries in the past quarter. Mr. Shone stated that the County must take into consideration the State's more aggressive nature and then complement that approach with more conservative investments. The County's pension fund also experienced lower volatility than its policy index over the past three years. Mr. Shone noted that Wilmington Trust had slightly underperformed their benchmark. By directive in the County's Investment Policy Statement, as well as by contract, Wilmington Trust is not allowed to buy more than 25 percent in corporate bonds, with the remainder to be invested in treasuries and agencies (Fannie Mae, Ginnie Mae, Sally Mae). These factors contributed to Wilmington Trust's underperformance.

Page 10 – Observations/State Pool – The State Pool had strong returns and is highly diversified. Mr. Shone reported that the State Pool is handled significantly different than the County's Investment Policy. The State Pool has approximately 25 percent in nontraditional assets (hedge funds and private equities). Due to the smaller size of the County's Pension Fund, this would not be recommended for the County. The State plan also has higher costs because of its nontraditional asset classes. Although the market was down for the last quarter, the State had a relatively good quarter – down 7.5 percent compared to 9.5 percent for the average plan. The County's plan was down 6.5 percent. Mr. Shone feels that the State Pool is a very integral and important piece of the County's portfolio.

Page 11 & 12 – Observations – Dupont Capital, Fidelity Low Priced Stocks, Vanguard Global Equity, Wilmington Trust Bonds – Dupont Capital had a relatively good year and surpassed their benchmark. Fidelity did better than expected, with Vanguard performing slightly below anticipated levels. Vanguard is a little more aggressive than Dupont and Fidelity, but Mr. Shone believes that the Vanguard Global Equity is a very good fund, although there may be others slightly better.

Page 13 – Consolidated Plan Performance Summary – There are \$47,418,757 in total assets in the County Pension Fund, of which the State Plan has \$31,102,670, or 65.6 percent. Mr. Shone noted one correction. The total fund return for 1 year (October 1 to September 30) should reflect a positive return of 4.7 percent. Through October, Mr. Shone noted that the County's rate of return was up another 6.5 to 7 percent. For the one year ending September 30, 2011, the average public fund was up .7 percent compared to the County's 4.7 percent. Ms.

Webb asked if a column of comparison could be added to the chart to show consecutive years of returns for each manager, in addition to cumulative returns.

To better respond to changing markets and to take into consideration the County's investment strategy, Mr. Shone recommended the Committee meet more frequently.

Page 15 – Based on investments by asset class (fixed income, cash, equities, etc.), Mr. Shone would not suggest rebalancing at this time.

Page 16 – Peer Group Comparison – Cumulative Returns – For the quarter ending September 30, 2011, the County's pension fund was down 6.6 percent (gross/before fees) and ranked 19<sup>th</sup> nationwide (1 being the best and 99 the worst). The year-to-date returns were down .6 percent. Of approximately 150 public funds, the County's fund ranked in the top 11 percent year-to-date, was in the top 8 percent for the one year, 17 percent for last two years, and for the last three years was in the top 20 percent. Plans that are more conservatively structured tend to do better when the markets are down and, generally, lag when markets are up. The County's plan has performed well in both markets.

Mr. Shone referred the Committee to page one of a separate handout regarding performance of the County's Pension Plan as of October 31, 2011. In particular, the Fidelity Low-Priced Stock fund was up 11.5 percent, and Vanguard Global Equity was up 10.2. Mr. Shone estimates the County's pension fund was up a total of 6.0 to 6.5 percent for the month of October.

#### Page 19 – Recommendations

- Stay the course – State Pool has done very well and the rest of the fund has complemented it well
- Quarterly reviews – (rebalance and manager evaluation)
- Invest 2011 ARC (Annual Retired Contribution) in short fixed income to match benefit payments. Ms. Webb reported that the Pension Plan is within \$200,000 of its annual budgeted contribution, and the OPEB is within \$16,000.
- Consider structured bond portfolio (bonds structured to match benefit payments; actuary provide future benefit payment projections)
- Vanguard Global (many more choices than 3 years ago – consider replacement)

Page 30 – Vanguard Global Equity. Mr. Shone reported that when the stock market went up 10 percent, Vanguard increased 11 to 12 percent. When the stock

market saw a 10 percent decline, Vanguard went down 11 to 11.5 percent. Vanguard performs better in the up markets and not as well in down markets.

Page 27 – Fidelity Low-Priced Stock Fund – While Fidelity does well when the stock market goes up, they do even better when the stock market is down. Mr. Baker noted that this particular stock been a very good performer for the County.

Tab II – OPEB Fund (Page 37 – Highlights):

- Total fund returned -10.3 percent for the quarter and -10.7 for the year-to-date
- Significant underperformance relative to policy index
- Adders, or factors, that worked for the County, included Ridgeworth Small Cap Value.
- Detractors included allocation to cash rather than fixed income securities; transition in up equity market; value tilt; Allianz RCM Disciplined Equity (overweight cyclical sectors); Dodge & Cox Global Equity (exposure to ‘deep value’ stocks)
- Decline in equity prices have left portfolio overweight fixed income

Ms. Webb noted that \$19.8 million was taken out of the State Pool to purchase investments. Alleviating the RFP process would have saved the County quite a bit of time in investing the cash. Mr. Shone explained how other clients do their investing, with some asking for more guidance, or actually requesting his firm to select their investments.

Taking into consideration the County’s investments, Mr. Shone stated that the County is his most conservative client, with the City of Wilmington being second. His typical clients range from 60 to 70 percent in equities. Given the County’s conservative nature, it was Mr. Shone’s opinion that the 60/40 allocation ratio was a good place for the County. Ms. Deaver expressed concern for an even more conservative approach. When asked regarding the OPEB’s current investments, Mr. Shone shared that he would suggest staying with Harding Loevner and to analyze the portfolio in the new year.

Mr. Baker noted that the negative returns were a result of the County investing in cash at .50 percent versus 3.4 percent for bonds, which would have allowed the County to have been relatively closer to the index. He offered that the time period from March 1 to the end of September (7 months) should be looked at to truly evaluate how this investment performed. This would match up how the County had the money invested and reflect the fact that the County could not invest the cash in bonds because of the RFP requirement. Mr. Shone noted that

this would not to make the return better, but would match up with what the County truly had available to invest.

Mr. Shone stated that he would email the revisions discussed to Ms. Webb who could, in turn, disseminate the information to the Committee members.

Page 45 – OPEB Recommendations (\$9.1 million total assets)

- Decide on how the County wants to invest its fixed income and implementation

Mr. Baker stated that the County could set up a separate account versus a mutual fund and use the exact guidelines utilized for the pension fund. The County could make direct contact with organizations requesting them to submit a proposal, or it could be done in-house – directly asking M & T for a price. Any recommendation would have to be brought to County Council.

A Motion was made by Mr. Baker, seconded by Ms. Deaver, that the Sussex County Pension Committee adopt the Pension Fund Investment Policy for fixed income investments for the OPEB Fund for the current time, and that the Committee authorizes the Finance Director to negotiate an agreement, with reasonable fees, with Wilmington Trust/M & T Bank for the OPEB Fixed Income portion of the fund.

Motion Adopted: 4 Yea.

Vote by Roll Call: Ms. Deaver, Yea; Mr. Baker, Yea;  
Ms. Brewington, Yea; Ms. Webb, Yea

Recommendations (Con't.)

- Lower allocation to small cap stocks
- Rebalance to asset mix targets (60/40)
- Broader diversification
- Index Large Core, Active on the Large Value
- Find a process to make more timely changes
- Review allocation and performance on a quarterly basis

At the end of September 2011, the County was at 45.8 percent in fixed income and the County has a target allocation of 40 percent. When asked about rebalancing, Mr. Shone recommended an overhaul of the County's portfolio and, at that point, the rebalancing could be done. Mr. Shone stated that Peirce Park

Group would be able to present the County with a rebalance sheet noting their recommendations. Ultimately, Mr. Shone recommended coming back to the committee with recommendations in January/February and rebalance the OPEB fund at that time.

### **FY 2012 Pension Contribution Recommendation for Pension and OPEB Funds**

Ms. Webb distributed and reviewed a handout entitled, 'Pension Committee Discussion Topics'. The recommendations for the annual contribution for the Pension Fund include: budgeted contribution of \$2,702,074; pension fund needs to reimburse General Fund \$2,526,246 for pensioner wages; and possible recommendation to put contribution in cash account staggering certificates of deposit as the funds are needed.

A Motion was made by Mr. Baker, seconded by Ms. Deaver, that the Sussex County Pension Committee recommend to the Sussex County Council that the 2012 Pension Fund contribution of \$2,702,074 be made to the Pension Cash Account, with staggered certificates of deposit.

Motion Adopted: 4 Yea.

Vote by Roll Call: Ms. Deaver, Yea; Mr. Baker, Yea;  
Ms. Brewington, Yea; Ms. Webb, Yea

Ms. Webb reviewed the recommendation for the annual contribution for the OPEB Fund, which included: budgeted contribution of \$1,694,914; OPEB Fund needs to reimburse General Fund \$1,657,640 for pensioner health benefits; and possible recommendation to put 2012 contribution in cash account staggering certificates of deposit as the funds are needed.

A Motion was made by Ms. Deaver, seconded by Mr. Baker, that Sussex County Pension Committee recommend to Sussex County Council that the 2012 OPEB contribution of \$1,694,914 be made to the OPEB Cash Account, with staggered certificates of deposit.

Motion Adopted: 4 Yea.

Vote by Roll Call: Ms. Deaver, Yea; Mr. Baker, Yea;  
Ms. Brewington, Yea; Ms. Webb, Yea

Mr. James inquired as to the possible need to increase the County's pension contribution in the future. It was explained that the specific annual Pension and OPEB contribution amounts are recommended by the County's actuary. As of January 1, 2011, the County's Pension Plan was 88.7 percent funded, with the OPEB having a funding level of 72.69 percent. Mr. Baker stated that an increase in funding is something that the Council may address in the future. It was explained that the County – for years –

funded the pension fund through the General Fund, which allowed the pension fund to build equity. Due to budget constraints, the Pension Fund now reimburses the General Fund on a monthly basis.

It should be noted that the Pension Fund items discussed today will be brought before Council on Tuesday, December 6, 2011, with Mr. Shone also in attendance.

### **New Member Discussion**

As a result of questions raised by Council during their November 8, 2011 meeting regarding the members proposed to serve on the pension committee, Ms. Webb provided the committee with a copy of a November 10, 2011 memo to Council relaying pension committee membership for New Castle County, Kent County, and the State of Delaware. She also provided copies of the actual information received from the State and both counties. Councilman Cole had raised concern regarding what he saw as an imbalance of representation by County employees recommended to serve on the Pension Committee. The proposed 7-member board would include the County Administrator, County Finance Director, County Human Resources Director, Council member, current County employee, a retired County employee who currently receives a pension, and a county community member. At the November 2, 2011 Pension Committee meeting, it was the committee's thought that who better to serve than the persons directly affected by the pension fund.

The State of Delaware has no State employee representation on their Board of Pension Trustees. Most members are retired or active professionals with some corporate investment experience. Their current 7-member Board of Pension Trustees includes the former President Corporate Development and Treasurer of Conectiv, the former Executive Vice President and Chief Operating Officer of Pepco Holdings, Inc.; the former Director of the Delaware Transit Corporation, the President of CTW & Consulting Associates, and the former Vice President of Salomon Smith Barney Consulting Group, as well as Ex Officio members including the State Secretary of Finance (Thomas J. Cook), and the Director of the Office of Management and Budget (Ann S. Visalli).

New Castle County has a 13-member Pension Board, which includes the Chief Human Resources Officer, Chief Financial Officer, the County Executive appoints 7 members from 5 designated unions, and the County Council appoints four members, none of which can be an official or employee of the County (2 of these four members must be in the banking or investment security business, and one must be a retired member of the program).

Kent County has a 5-member Pension Review Committee consisting of three citizens – appointed by the Levy Court, the Finance Director, and an employee representative.



Ms. Webb questioned Mr. Shone as to his experience with the structure of other Pension Committees. In Pennsylvania, he explained that it is mandated by law that members include the three County Commissioners (who are the executives of the County), the Treasurer, and the Comptroller (all elected officials with full-time employment with the County, no retirees, no outsiders). Out of 13 board members for New Castle County, two or three were outsiders. He noted the difficulty in getting an outsider willing to serve as fiduciary of the plan, with the time also available. The City of Wilmington is reflective of the norm – fairly equal representation between management and labor. As fiduciary of the plan, Mr. Shone stated that the committee has to represent the interest of the County and the beneficiaries of the Pension Plan (the participants), and must be cognizant of the impact of the decisions on the County budget. Ms. Webb noted concern that non-County members not have greater representation than County members. Mr. Shone also offered that the larger the group, the less likely for a quorum, and noted the importance to include the Finance Director – people with financial background and knowledge – as well as Human Resources. In addition to equal representation between management (Treasurer, Comptroller, Finance Director) and labor, the Mayor for the City of Allentown, Pennsylvania, also appoints someone to serve on their pension board, as does City Council. He noted that the City underwent a 4-month process to find an additional outside appointment to serve as the tie-breaking vote. The person ultimately selected was the retired Finance Director for the City. Mr. Shone that in his experience it is unusual, but not unprecedented, to see an outsider serve on a pension committee.

When asked by Ms. Deaver, Mr. Shone stated that the City of Allentown does have an elected official – the Comptroller – serving on their pension board. Ms. Deaver stated that the persons serving on these pension boards seem to have knowledge with investments. It was also noted that Kent, New Castle, the State, as well as Sussex, all have financial consultants.

The Committee discussed various options that included keeping the total members to 7 as proposed, removing one member to enable a second outside person to serve. Ms. Deaver stated the crucial need for members to have experience in the investment field and questioned the need for County Council representation, noting her inexperience. Mr. Baker and Mr. Shone both felt that a Council member would be a beneficial component of the Committee. Ms. Deaver stated that she felt that there would no other individuals wanting the pension plan to be more successful than the employees.

Ms. Deaver questioned if meeting notices were posted. It was explained that meeting notices are, in fact, posted at the County Administration Building, and meetings are broadcast over the internet. In the future, agendas and minutes will be posted on the County's website.

It was the consensus of the Committee to recommend to the Sussex County Council that the 7-member Pension Fund Committee include the members as originally proposed:

County Finance Director, County Administrator, County Human Resources Director, Sussex County Council member, Sussex County community member, a current Sussex County employee, and a retired Sussex County employee who currently receives a County pension.

### **Discussion of the Sussex County Fire Service Trust Fund**

Ms. Webb reviewed the discussion that took place during the November 2, 2011 Pension Committee meeting. At that time, a suggestion was offered to invest the \$10 million investment for the Sussex County Fire Service Fund in Sussex County bonds. In particular, the option of lending the \$10 million to a County sewer district had been discussed. Ms. Webb noted that the budget ordinance did not name the investment and, if the Committee was uncomfortable with the name of 'fire service fund', it could be titled the 'Sussex County Investment Funds'.

It was noted that the asset allocation for this fund would be very conservative and would include 100 percent fixed income. Ms. Webb offered that the County would lend the \$10 million to the SCRWF sewer district and refinance an outstanding SRF Bond – SCRWF Project, Series 2002. The sewer district would pay the County 3.175 percent and would be paid off December 30, 2026. There is, however, a risk of no collateral if the cash should need to be returned to the General Fund. There would be no change in the debt service. Mr. Baker noted that the Bond Investment Advisor had relayed that they County could not refinance at a better rate than the 3.175 percent. The disadvantage would be when, and if, interest rates go up, it would be difficult to get out of this agreement.

Ms. Webb noted that she had not gotten an answer from the auditors as to how this option may affect the County's financial statements. She reported that another option to consider would be the continuation of a fixed asset investment portfolio. Mr. Baker stated that the County is also waiting on the amortization schedule from the bond financial advisor.

Mr. Baker offered that the Committee could make recommendation to Council to consider lending the County sewer districts the \$10 million with no markup, which would result in the district paying the existing rate. As the money is paid back into the investment fund, the County could look into investing it as per the pension fund fixed income policy.

Ms. Deaver, again, questioned the benefit of taking \$10 million and treating it as a separate grant. Ms. Webb noted that she felt the new fund was driven by the bad economy and would allow the County to have a source of funding if the economy declined again. This new fund would allow the County to have another stream of dedicated funding so the Fire Service would know the County would, hopefully, not have to make deep cuts to the fire service. It was explained that the fire service

provides essential services which are very costly. If the County were to have to take over these services, it would have a tremendous impact on the County's budget. The fire companies have expressed their workload and difficulty recruiting volunteers, the costs associated with paid BLS staff, as well as the overall costs associated with providing these services. It was noted that this proposed grant is over and above what the County currently provides to the fire services. Taking into consideration the new information presented regarding the exorbitant cost of providing these services, Ms. Deaver stated her approval of this additional funding source for the fire service.

A Motion was made by Mr. Baker, seconded by Ms. Brewington, that the Sussex County Pension Committee recommends the County Council consider the Sussex County Investment Fund invest \$10,000,000 in a loan to the County sewer districts as part of the refinancing efforts currently underway, at no above market costs to the sewer districts; and invest principal proceeds from that loan with a laddered fixed income approach, with a maximum 14-year investment.

Motion Adopted: 4 Yea.

Vote by Roll Call: Ms. Deaver, Yea; Mr. Baker, Yea;  
Ms. Brewington, Yea; Ms. Webb, Yea

Ms. Webb stated that she would be making the fire service and pension contribution recommendations to Council on December 6, 2011.

Ms. Webb thanked Mr. Shone and Peirce Park Group for the tremendous assistance and work they provide Sussex County.

### **Other Business**

None

At 3:35 p.m., a Motion was made by Ms. Deaver, seconded by Mr. Baker, to adjourn. Motion Adopted by Voice Vote.

Respectfully submitted,

Nancy J. Cordrey  
Administrative Secretary