MINUTES
PENSION TRUST COMMISSION
SECOND FLOOR CONFERENCE ROOM
CITY HALL
JULY 26, 2018 – 9:00 A.M.

Bart Hadley called the meeting to order at 9:00 a.m. in the City Hall Second Floor Conference Room. Notice of meeting and agenda was posted on the City Hall notice board as required by law.

ROLL CALL
PRESENT: Bayones, Teri; Dentler, Carl; Ellwanger, Paul; Hadley, Bart; Hill, Andy; Livingston, Steve.
ABSENT: Petersen, Ed.
ALSO PRESENT: Denise Ezell, City Clerk's Office; Perry Warren and Chad Rother, Morgan Stanley; Warren Wick, Human Resources.

II. Introduction of Visitors

Hadley stated we don't have any visitors today. I would like to announce that Ed Petersen has been appointed to the Commission. By the time I had made contact with Cherry Phillips Petersen had accepted the appointment. She is interested in serving if we have a vacancy.

Hill stated I'm at a place where I'm right on the bubble. Phillips might have the opportunity to be my replacement. This is just a heads up for the Commission. My wife is at a point I need to be home in the mornings.

Hadley stated we certainly understand.

III. New Business

A. Approve minutes of April 26, 2018.

<u>**Motion** by Hill, **Second** by Bayones</u>, to approve the minutes of April 26, 2018. **Aye**: Dentler; Ellwanger; Hadley; Hill; Livingston; Bayones. **Nay**: None. **Motion Passed**.

B. Receive quarterly financial report from Morgan Stanley and take action if necessary – Perry Warren, Morgan Stanley.

Warren stated good morning. We appreciate the opportunity to provide an update on the account. Let's start by turning to page 4. Page 4 and 5 reflect the calendar years return going back to September 28, 2001. To the far right you see in 2018 we had a great January by being up 3.93%, followed by a negative February and March of 2.63% and 1.33%. This produced a negative return for the first quarter of negative .15%. The second quarter has shown improvement with all 3 months having positive returns of .02% in April, 1.67% in May and .17% in June. This produced a positive return for the second quarter of 1.86%. The first half of the calendar year was up 1.71%. In the upper left hand corner on page 6 you see the time weighted return net of fees section. Let's review the performance from November 15, 2007 to June 30' 2018. The beginning value was $34,679,131.46 on November 15, 2007, net withdrawals of $5,994,874.34, investments earnings of $26,169,482.19, leaving an ending balance of $54,853,739.32. In the last 12 months column you see a year ago on June 30th we had $51,097,098.59, withdrawals of $900,000, investment earnings of $4,656,640.73, leaving an ending balance of $54,853,739.32. Let's look at the return net of fees. The last 12 months we earned 9.17% compared to our benchmark. The ERSOCOL benchmark stands for Employee Retirement System of City of Lawton. From now on we will call it the benchmark of 6.86%. The last 3 years we have earned 6.64% compared to our benchmark of 6.3%. Since inception we have earned 5.5%. In the chart in the upper right hand corner you see the blue line is our account and the red line is our new benchmark. You see early on we benefited from having only 35% stocks and 65% bonds. The blue line did not decline as much as the red line. It became clear that the bond yields would remain low for an extended period and we suggested you allow us to change the allocation to 50% stocks, 50% bonds and cash allocation with a variance of 20%. As you can see by the chart it was a timely change and has allowed us to make the actuarial of 6.75% return over the last 6 years. Turn to page 7.

Hadley stated the last 12 months we had net contributions withdrawals of $900,000. Was that an estimate from finance?

Warren stated no. That is the amount that came out of Morgan Stanley. We talked about there would be roughly $300,000 per quarter for withdraws. I report on what I have at Morgan Stanley. Finance has the judgments and some money. There are times they don't pull the whole $1.2 million. We have talked with Stephanie to make sure she gives us a heads up. Now is a good time to withdraw because I have money set aside for the withdrawals.

Hadley asked on the retirement system benchmark for the last 12 months does it look like an odd number, 6.86%, because we change the benchmark.

Warren stated no. That was the actual return. If we had been at 50/50 the last 12 months we would have made 6.86%. That benchmark is the allocation of stocks and bonds. It is more diverse than that because so much is the Russell 1000 growth and so much value. It is a big index. The bottom line is it is about half stock and half bonds.

Hadley stated I was tying the benchmark into the 6.7%.

Warren stated we have 2 benchmarks. The reason for this benchmark is because the goal is to make 6.75% and to do it with the least amount of risk. When we changed the performance analysis we fixed it so there was no reason to try and make 10%. We are trying to make as much above 6.75% as we can with the least amount of risk. We didn't make the actuarial number on the 3 year but we got close. I want some way for the Commission to know if we made 6% and the benchmark stated 6.3% then you have a problem with me. I also didn't want to be in a position that was the opposite. We made 6.6% but the benchmark made 6.3%. You had no way of knowing that we were doing better than the benchmark. That was the reason for setting it up so you could see. If we had been at 50/50 we would have underperformed by .34%. If we were

35/65 it would have been easy to outperform. When we changed the allocation we needed to change the benchmark to something comparable to what we are trying to accomplish. We have 2 things. The 6.75% or what the benchmark would allow us to do. On page 7 there are a couple of items I want to cover. Let's start with the chart in the upper right corner. This chart is the total value versus net investment capital. The red line represents the money placed with us less withdrawals. The light blue line represents the total value of the account. You see the balance has continued to grow. Not each quarter but over time. The difference in the total value in the net invested capital line is the money that the account has made. Look to the left at the last 5 years column and the 6.77% return net of fees. I'm very happy about that return. The next page is the portfolio x-ray. We use this printout drills into all the holdings to see our allocations. You see as illustrated by the pie chart that the portfolio is currently allocated with 8.75% cash, 56.32% US stocks, 8.756% non US stocks, 24.68% bonds and 1.67% in other. Look to the tic-tac-toe boxes in the middle of the page. The one on the left shows we have the majority of our bonds in limited duration. This reflects our beliefs that rates would rise. To the right is the equity style box. You see we are now allocated 24% large value, 25% large blend, 29% large growth. We also have 5% allocated to mid value, 5% mid blend and 8% mid growth. The last 12 months large growth has outperformed large value by 15.74%. This outperformance has caused us to do some rebalancing from growth to value and from large caps to small caps. We had to sell stocks to buy bonds since stocks have outperformed bonds by a large percentage. Turn to page 16. Notice under fixed income in the preferred section the holding Vanguard Total Bond Market. This position is designed to reflect the whole bond market. It looks like the Barclay's Aggregate that represents the bonds in our benchmark. The last time it had a yield of 2% and now it is 2.65%. We are glad rates have risen and will be glad when they rise to where we can earn our actuarial return with 50% more allocation to bonds. Since we have owned this holding the increase in yield has caused a decline in the price of the position to equal over 1 ½ years of its current estimated annual income. This is why we invested our maximum in stocks over this period. On page 19 you see the time weighted performance summary. I want to go over the return net of fees and a few things I find interesting. Notice the performance net of fees for the last 12 months of 9.17%, since we updated the benchmark is 11.16%, last 3 years 6.64%, last 5 years 6.77% and since November 15, 2007 5.5%. Our benchmark only made 6.3% over the last 3 years but we were very close to earning the 6.75% by earning 6.64%. I told you growth had outperformed value over the last 12 months by 15.74% and this is where I got the information. You see the return on the Russell 1000 growth for the last 12 months was 22.51% and Russell 1000 value was 6.66%. The return on the Barclay aggregate for the last 12 months was a negative .4%, last 2 years negative .36%, last 3 years 1.2% and last 5 years 2.27%. We discussed it was very likely that the returns on bonds would fall or remain low as they have. I want to thank the Commission for working with us and making the allocations that were suggested. Our goal is to work to reduce the allocation in stocks as rates rise and to earn the actuarial 6.75% with a reasonable expectation on return on stocks. Until then we will continue to be overweight to stocks giving us the best change over the long haul to earn the 6.75%. The Commission must be willing to continue to accept the volatility that comes with it. Turn to page 20. We always want to remain mindful of an increase in volatility that we must endure with the higher allocation in stocks. We were basically forced to increase our allocation to stocks or accept the fact we could not make our actuarial number the last several years due to the yield on bonds. Over the last 3 years our benchmark did not earn the actuarial return. We review this chart at each meeting to stay aware of the volatility that happens each year. The red dots represent the maximum intra-year decline. The blue bars represent the S&P 500 annual returns. If invested in 100% S&P 500 you would have had to tolerate a median decline of 10% to turn a positive 12% return over time. That doesn't sound too bad until you look at the returns that make up those averages. There are 5 intra-year declines of negative 28 or more from 1980 to present. Declines of that magnitude would surely test anyone's convictions. We want to confirm those convictions with the board each meeting. We believe we are currently allocated where we need to be, within the guidelines, to have the best chance to make the actuarial assumption over time given our current investment environment. As of this morning the value of the account was $56,413,512. Year to date we are up 4.63%. Thanks for the opportunity to work with you and manage the account.

Ellwanger stated help me understand credit quality on page 5.

Warren stated the bonds we have in the portfolio have a manager. They drill in and know the credit quality and the individual position they hold. This shows that 41% of the bonds are AAA, 5% is AA, 10% in A, 12% B, 5% BB, 3.32 B and some are not rated. Not rated doesn't mean they are not good enough to be rated they just don't go to the trouble of rating them. All the holdings we have are AAA that I pick.

Ellwanger stated there is 12% in BBB. Does that mean the whole fund is rated BBB or only certain investments within the fund.

Warren stated within all the holdings we own there is 12.63% rated BBB. We had federated high yield fund and I sold it a year ago. There will be a time where we own high yield bonds but the return we were getting was so close to what you could get on sacred bond I did away with that fund. We have funds that are strategic income or have some of that in their portfolio. Bond managers are making the decisions back and forth between higher quality and lower quality. It is better for them to do that on an individual basis than for me too. I want to know the fund manager and their track record to make certain we have the best managers. The Commission has asked if there was something in our guidelines that we might need to change to help aid performance. Because of the out performance in large cap growth the bond managers knew they were getting pricey. Our large cap growth manager has been looking for bargains in mid cap growth. All of a sudden you look up and our target is 25/25 in large and 5/6/5 in mid. Because of the performance and the shift we are out of range on mid cap growth. That is great and it is kind of your smoothing mechanism to make sure we don't get too far out. This is what causes the rebalancing. This has happened in our past. In 1995 to 1999 growth had a period where it greatly outperformed value. It outperformed value so much that the Value Funds changed their name to Capital Opportunity because nobody was investing in them. This ended in 2000 and we had a big sell off and a massive rebalancing. The equity style box of the portfolio x-ray forces us to sell something that is high when it gets out of whack. This is what happened. All of a sudden instead of being 8 we were 12. That gave me an opportunity to move from growth to value. On page 19 you see what makes the formula for the allocation. I stated that bonds were performing poorly. Look at the "since the beginning". The Russell Growth made 10%, Russell Value 6.4% and bonds were still making 3.76%. We don't know the future but we do know the past and current economic environment. If we were using those number to figure out how to make the 6.75% you can mathematically do it. That is the reason why knowing the

3.76 was going to continue to drop we had to take something simple to make it simple. If bonds were making 4 we are getting 2. In order to get to 6.7% we need to make 4.75 from stocks and double that is around 11.25%. We are expecting quite a bit. Hill stated he had been doing some studying trying to figure out how things are and why you do certain things. You have to take those numbers for a long period of time. What do we expect from our stocks? If we say 5 then there is 5 if we are 50/50. To make another 1.75 we need to be at 3.5 on bonds to be 50/50 if we are going to be 10 from stocks. Stocks may make more. I'm conservative and would rather expect less from stocks. That is the reason for the shift in allocation. I love the day when we are making 7% on bonds. We lock that up for a longer period of time and we don't have to worry about having bonds that aren't higher rated. That is the reason I took out the high yield bonds. We are only making a percent more than what government bonds would make. Everyone bought high yield because they didn't want to own stocks. I would rather take the allocation that is in high yield with half in stocks and half in bonds because we know what we have. That is ongoing. What is going to change is our allocation to equities is down 3.70%. I pulled it back because bonds have underperformed. I put $2,000,000 more in a fund that I have plans for distributions because it doesn't go up or down and is steady. It doesn't make a lot of money but making 1.3% is better than what bonds were making the first 6 months of this year. The chart on page 19 shows the last 12 months bonds made a negative .4. Most of this was from the first 6 months and treasuries have gone from 2% to 3 on a 10 year treasury. We want to grow the money and in order to grow we have to have a higher allocation to stocks. We also have $1.2 million that comes out. If I think rates will rise I want to have money in an account that doesn't go up and down. Look at the position. Right now we have a little over $4,000,000 in ICIFX. That is the account I put the money into so it wouldn't be affected by either of the things I anticipate to happen. We have a lot going on in our economic environment and we are a long term account. I'm working towards getting down to 60, if bonds will cooperate, and that gives us the position to get back within our range. We are not trying to market time but we want to be aware of the fact that we have outperformed the index the last 2 years by 3%. That is because of our overweight in equities. Bonds are getting closer to where we are forced to do this. We are at our maximum weights in equities. As equities outperform bonds we are forced to buy more.

Ellwanger stated thank you.

Motion by Ellwanger, **Second** by Livingston, to accept the Morgan Stanley quarterly report. **Aye**: Ellwanger; Hadley; Hill; Livingston; Bayones; Dentler. **Nay**: None. **Motion Passed**.

C. Receive Quarterly Employees Refunds Made From Retirement System and Receive Quarterly Statement of Receipts and Disbursement and take action if necessary – Finance.

Hadley stated I apologize for not having someone from finance here. We can approve the quarterly statement or table until the next meeting.

Motion by Hill, **Second** by Ellwanger, to table the treasurer's report until the next meeting. **Aye**: Hadley; Hill; Livingston; Bayones; Dentler; Ellwanger. **Nay**: None. **Motion Passed**.

D. Discuss the Requirements of City Code Section 17-3-4-344 “Mandatory distributions”, and if necessary, take appropriate action to address a potential interpretation issue with the language therein,

Wilson stated the City Attorney noticed this provision and it gave him some concern. This deals with mandatory distribution in 344(a)(b). It talks about the time and manner of the distribution. Specifically in the paragraph that talks about the death of a participant. It reads: “Death of participant before distributions begin. If the participant dies, before distribution begins, the participant’s entire interest will be distributed, or begin to be distributed, no later than as follows: (a) If the participant’s surviving spouse is the participant’s sole designated beneficiary, then, except as provided in the adoption agreement, distribution to the surviving spouse will begin by December 31 of the calendar year immediately following the calendar year in which the participant died, or by December 31 of the calendar year in which the participant would have attained age seventy and one-half (70 ½), if later.” Jensen’s concern was if an employee were to die before contributions began that whoever was administrating the plan might say you had to wait until December 31st of the next year before you could receive the death benefit from the retirement system. I contacted Papahronis, the pension attorney, and he advised that is not his intent or understanding. He stated the IRS required language that talks about when a participant has to begin or when distributions have to begin. This is IRS regulations because they want to get their tax money. There was conversation about making some modification to the language to make it clearer. Papahronis has concerns about making modifications. A few years ago he submitted a Determination Letter to the IRS asking them to review our plan to make certain it met their regulations and to issue a Determination Letter. The IRS did that.

Hadley stated this provides some protection to the Trust. We can fall back and say the IRS said this is correct.

Wilson stated the IRS no longer does a voluntary Determination Letter. If we modify our plan we lose the ability to rely on the Determination Letter. Papahronis is willing to provide an opinion letter to the city/trust stating the intent of the language. The intent is not to force the spouse of a participant who dies to wait almost another year before receiving benefits. It is to make it that you have to start taking it by this age or date so the IRS can get their taxes. Papahronis is willing to write an opinion letter. My direction was to bring it to the board to see if there was an interest in authorizing Papahronis to write an opinion letter.

Hill stated when I read December 31st it cleared it up for me. What was confusing for me was the 70 ½ if later. If a person dies at 65 70 ½ is 5 ½ years later.

Warren stated their spouse could be older.

Hill stated so we are talking about the spouse. If we have a letter then I don’t see a need for a change. What will Papahronis charge?

Wilson stated his rates is $360 an hour.

Hadley stated the practice hasn't been using this to deny anyone immediate monthly benefits. There is a concern that somebody could make the determination based on the language. An opinion letter from Papahronis would eliminate that from happening. There will be a cost that is why we brought it to the Trust to see if you wanted to spend the money on an opinion letter.

Ellwanger asked has this come up.

Wilson stated no.

Livingston asked do we want to wait until it comes up. What direction do we want to go?

Ellwanger asked is there a recommendation from the City Attorney's office.

Wilson stated we recommend doing the opinion letter.

Bayones asked to cover ourselves.

Hadley stated yes.

<u>**Motion** by Ellwanger, **Second** by Dentler</u>, to accept the recommendation from the City Attorney's office to ask John Papahronis, the pension attorney, to do an opinion letter on City Code Section 17-3-4-344 "Mandatory distributions". **Aye**: Hill; Livingston; Bayones; Dentler; Ellwanger; Hadley. **Nay**: None. **Motion Passed**.

IV. Old Business

A. Consider application for normal retirement from Ingeborg M. Wilson.

Hadley stated this was on the consent agenda last meeting. We were approving the application for normal retirement but the application didn't have her spouse's signature.

Wick stated the Oklahoma Public Employees Retirement System states that spousal consent is required by statute.

Hadley stated she was married at the time of retirement.

Bayones asked do we need to get her and her spouse to sign the application.

Hadley stated if they are willing to do so. If not I don't know that we have any recourse. She is drawing her pension and this happened because we didn't handle the paperwork appropriately. I don't think we could or would want to stop her pension to force her to come in. I don't anticipate a problem. I hate to do this but I would suggest we table this to see if we can acquire the appropriate signatures.

Wilson stated the section Wick sited is for the Oklahoma Public Employees Retirement System and we are not under OPERS. Our requirement is in Title 11. I believe it is a good practice to have the beneficiary/spouse to sign the paperwork.

Ellwanger stated the beneficiary could have an issue

Hadley stated I believe her husband is older and that may be part of the reason she selected this option.

Bayones stated according to the application they have the same birth year. She chose the Lifetime Only option. Other than him not being the beneficiary I wouldn't think it would cause any problems not having his signature.

Hadley stated he has a right to say no if he wants the survivorship when she passes. He might have a claim if he lost the retirement.

Livingston asked are they having trouble communicating with these people.

Ezell stated when this duty was given to another employee and she didn't realize a signature was required.

Livingston stated so the applicant isn't refusing to sign the application.

Hadley stated no. I fully suspect once she is contacted they will come in. If there is a disagreement between the two of them I don't know where we stand. We would research it at that time.

Wilson stated it is my understanding that the practice has always been that you have the spouse sign the form.

Hadley stated correct.

Motion by Ellwanger, **Second** by Hill, to table this item until the next meeting. **Aye**: Livingston; Bayones; Dentler; Ellwanger; Hadley; Hill. **Nay**: None. **Motion Passed**.

V. Consent Agenda

FOR THE BENEFIT OF THE AUDIENCE, ALL MATTERS LISTED UNDER THE CONSENT AGENDA ARE CONSIDERED TO BE ROUTINE BY THE PENSION COMMISSION AND WILL BE ENACTED BY ONE MOTION. THERE WILL BE NO SEPARATE DISCUSSION OF THESE ITEMS. IF DISCUSSION IS DESIRED, THAT ITEM WILL BE REMOVED FROM THE CONSENT AGENDA PRIOR TO ROLL CALL AND WILL BE CONSIDERED SEPARATELY.

A. Consider application for normal retirement from Thomas Blackstar, Jr.
B. Consider Memo of Information regarding the death of employee Brenda M. Smith

C. Consider application for early retirement from Michael Hardick.
D. Consider application for normal retirement from Jackie L. Somerlott.
E. Consider application for normal retirement from Richard J. Carlson.
F. Consider application for normal retirement from Dennis A. Bothell.
G. Consider Memo of Information regarding the death of employee Michael L. Shaw.
H. Consider approval for the paid-in-full judgments to be released from the record.

Motion by Hill, **Second** by Ellwanger, to approve the consent agenda. **Aye**: Bayones; Dentler; Ellwanger; Hadley; Hill; Livingston. **Nay**: None. **Motion Passed**.

VI. Comments

VII. Audience Participation

VIII. Adjournment

There being no further business the meeting adjourned at 9:50 a.m.

Motion by Dentler, **Second** by Ellwanger, to adjourn. **Aye**: Dentler; Ellwanger; Hadley; Hill; Livingston; Bayones. **Nay**: None. **Motion Passed**.