MINUTES
PENSION TRUST COMMISSION
SECOND FLOOR CONFERENCE ROOM
NEW CITY HALL
JANUARY 26, 2017 – 9:00 A.M.

Bart Hadley called the meeting to order at 9:00 a.m. in the New 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: Kindt, Bill.
ALSO PRESENT: Tim Wilson, City Attorney's Office; Denise Ezell, City Clerk's Office; J.I. Johnson, Finance Director; Perry Warren and Chad Rother, Morgan Stanley.

II. Introduction of Visitors

III. Approval of Minutes from September 27, 2016

Hadley stated Warren found in the last sentence of the next to last paragraph "1%" should be "0.1%". On the tenth line down first paragraph on page 5 "underscore" should be "underperform" and the last line "using" should be "providing".

Motion by Bayones, **Second** by Dentler, to approve the minutes with stated corrections. **Aye**: Dentler; Ellwanger; Hadley; Hill; Livingston; Bayones. **Nay**: None. **Motion Passed**.

IV. New Business

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

Warren stated we would like to thank the board for the opportunity to be here every quarter to provide the update. At our last meeting in September I went into more detail when we looked at the investments of the portfolio and we reviewed the top 5 holdings. I would encourage any of the members to reach out to us if you have any questions between meetings. We make education a big part of the quarterly updates.

Warren stated let's get started on page 4. You can see the performance of the portfolio for each year going back beyond the consolidation with us in November 2007. We would like to point out the results from 2016 of 7.05% net after fees which exceeded the 6.75% actuarial number. This is one of the 2 measures we are trying to outperform. As we continue to mention it is not a straight line to 7.05%. As noted by the breakout of each month looking back to the start of the year you see January was a negative 4.78% leading the 5 negative months of the year. March was up 4.87% and leads the positive 7 months of the year.

Warren stated please turn to page 5. You see we made a good decision to change the allocation from 35% in equities to 50% with a variance of 20% plus or minus. Our index created by using the portfolio asset allocation targets which we call ERSOCOL. ERSOCOL means Employees Retirement System of the City of Lawton. Benchmark is located right below the Return % (Net of Fees) on the chart. You see the confirmation of what we have discussed has played out over the last 3 years. We would not have made the actuarial number even with the benchmark targets of 50% bonds 50% equities. The reason we underperformed our index during that period of time was the changes in our allocations. We didn't make the changes until 2014. With current rates and expected future rates for bonds they are expected to produce lower returns. We have been clear that we believe the account needs to be allocated towards the maximum equity rating. This allocation is based on the objectives to make the actuarial number if possible within the investment parameters. Please look at the line directly below the ERSOCOL. I'm going to start calling it our index. Look at the Barclays Aggregate Bond and start with the far right side of the line where you see the return since November 15, 2007. The aggregate bond has made 4.17%, then 2.24% the last 5 years, 3% the last 3 years and 2.65% in 2016. The last quarter of 2016 fail by a negative 2.8%. This is the effects of rising interest rates. To not lose track of my point I want to say the decision to increase our targets mathematically is the correct one if we are going to continue to attempt to make the actuarial number. We want to make it clear that we are not expecting equities to make more than their long term averages over the next 20 years. It is our belief that bonds will make between 2 and 3% for the next several years. If you look at the chart that we just discussed you can see why I believe it will be 2% or 3%. That is what it has made over the last 5 years and rates have been declining and then stayed steady since 2010. With that belief and to attempt to make the actuarial number we are allocated appropriately. Before we move to page 6 I want to give you a few numbers for reference. A portfolio that is allocated 50% bonds and the bonds return 2% the remaining 50% allocated to equities would have to make 11.5% to equal the 6.75% actuarial number. Continuing with the same allocation if bonds return 3% the remaining 50% would have to make 10.5% to equal the 6.75%. Based on our current allocation if bonds make 2% the equity needs to roughly make 8.8% to make our 6.75% number. Continue with the same allocation if our bonds return 3% the equities would need to make roughly 8.36% to make the actuarial 6.75%. We believe our current allocation long term gives the portfolio the ability to achieve the 6.75% over time if we are willing to handle the higher volatility. The month to month on page 4 is an example of the volatility we expect each year.

Warren stated please turn to page 6. This gives us information since November 15, 2007 thru December 31, 2016. Under the Performance Inception heading it shows when we consolidated the account and the balance was $34,679,000. Since then we have had $4,194,000 in withdrawals and investments earnings of $17,989,000. The graph to the right illustrates those numbers. The difference between the blue line and the red line at the end of the chart represents the $17,989,000.

Warren stated page 7 is the same information we saw on page 4, 5 and 6 but I want to talk about the chart that illustrates what we are saying about the allocation changes. You notice the index dropped more than the portfolio in 2008 and it took the index until 2013 to outperform our old allocation. What happened is rates did not recover and declined further is the reason we asked the Board to consider the allocation change and the Board should anticipate that we would continue to adjust the allocation to reduce volatility from here as returns on bonds improve in the future. We are here because mathematically it is where we have to be to make the actuarial assumption. If the Board doesn't want to have that much volatility we are your chauffeurs and you are telling us where we are going. We can reduce it but reducing it also reduces the likelihood of the returns based on the numbers I previously gave. You can see on the chart how it dropped down because it had more equity exposure. We were around 35 to 45% stocks in 2007 and 2008.

Warren stated let's turn to the next page. The Portfolio X-Ray shows the current allocation of the portfolio. I believe you have all become familiar with this report over the years. It shows several things I want to cover again. Our belief is rates will continue to move higher but we are uncertain on how much and when. The fixed income style box illustrates our stance on rates with our current allocation of 41% to moderate duration, 31% in short duration and 6% in long duration bonds. Our overall effective duration is 3.57 years. Move to the equity style box where you can see that our allocation is 70% large cap, 23% mid cap and 7% small cap. This reflects the overweight portion of equities is allocated mainly to large cap. Look at the triangle at the top. It shows how we are allocated according to sectors. We are very neutral and we believe we should be based on the long term nature of the portfolio.

Warren stated page 13 is a summary of the account holdings listed by cash, equities, fixed income and alternatives.

Warren stated turn to page 14. Last time I went over the 5 largest holdings. I covered their performance, why we own them and whether they were active or passive investments. Today I will only make a couple of observations. One is the Vanguard Total Bond position at the bottom of the page. It shows that we own 33,730 shares valued at $2,733,000. The next line over shows the decline in value since we established the position. The next number over shows the expected annual return of $67,291. I reviewed this position last time since it is one of the largest holdings and it represents the total bond market. The next line over shows the yield to cost of 2.42% and a current yield of 2.46%. As we have mentioned and anticipate over time that the current yield will rise. When it rises high enough we plan to reduce our allocations to equities. Note that during the time we have held this position we have nearly accumulated a loss equal to 1 years anticipated income. This is an illustration of what we have reduced by our changes to the allocation of 65% bonds to 50% with our current allocations at the minimum weight.

Warren stated it wouldn't be a meeting without referring to the chart on page 19. This chart illustrates the S & P 500 annual return and intra year decline. We go over this chart every meeting because volatility is part of what we have to expect. Last year the market's intra year decline was 9%. This was 1% less than the median of the10% decline. We reviewed the effects of this on the portfolio earlier on page 4 where it showed the decline of negative 4.78% in January and negative .17% in February for the first 2 months of 2016. The account recovered the negative 4.95% decline and over the remaining 10 months made enough to end to the year at 7.05%. I point this out because I don't know the decline in 2017. I don't know if it will be above or below the average decline. We will likely have a decline and we need to anticipate now what our response will be when it occurs. Will we allow the portfolio to recover like it did in 2016? If the answer is yes we don't need to make any adjustments now. If we are unsure we need to discuss and consider the changes now to avoid the making of an allocation change at the wrong time. I want to thank the Board for allowing us to assist in the retirement system and we consider working for you an honor. Are there any questions?

Hadley asked can you talk about your last point a little more. Do you anticipate anything being different this year? Are you expecting something different that would change your recommendation of what you feel we should be doing?

Warren stated if we weren't trying to make the 6.75% we could be closer to the 60% in equities as opposed to being at 70%. The reason we are at 70% is I want to be in a position that if the market does well we would be selling stocks while they are high. Hopefully interest rates will continue to rise so we can buy bonds at a higher interest rate. I keep pointing this out because ya'll are the Board and we need to be willing to accept we are going to have ups and downs. This is a long term account. When you have a long term account you have to be in the right position. I wanted to state through my presentation that we didn't change until 2014. On page 5 go to the 3 year chart. The benchmark made 5.16% over the last 3 years. It would not have made the actuarial number at the targeted allocation of 50/50. That's not bad and it's not going to always do it over a 3 year period. If we reduce the equity position it greatly reduces the likelihood of getting 6.75%. Where we are allocated is okay as long as we are long term. The reason I bring it up is for everybody to have input. We don't want to do what the average investor does. The average investor is managing because it is their pot of money. It's not a pool. They may take it and spend it. What they do is give up. If we had given up last year what would we have done with the money? We would have locked in the loss and be right where we are. What happens is the average person gets out; the market rallies and they don't ever make the money back. They re-engage and then it rolls over. We are going to have volatility and last year we were kind of in the middle of the road. We are more diversified than the S & P 500 because we have small cap, mid cap, international and alternative. Our bonds are more diversified. Last year was a good example of the volatility we are going to have if we continue to try and make the 6.75%. I don't know of any other way to try and achieve that. I believe to expect 10.5% out of the market is asking a lot. It's not that I'm overweight or bullish on equities. What I try to do is within the long term averages to be in the right position. Like we have said before you are going to make the coupon of your bonds over time. Coupons now have been set to lower yields. I believe there is going to be a change in interest rates. I'm not afraid of change but mathematically if we are going to get the 6.75% I think we need to be closer to our current allocation and we can pull back. As the current yield goes up we can move allocations from equities to bonds because we don't have to make up as big a hurdle with what is left. I think it is appropriate where we are but what I don't know is how the Board will react when we come back and we are down $4,000,000 and it can happen. We are long term and that is the reason I spend most of the time on what are we going to do.

Hadley stated in my tenure I think the Board has been pretty consistent in realizing that we are in this for the long haul. Pension plans are suppose to be in it for the long haul but we do have an item on the agenda that puts a potential sunset date on this plan. It is a long ways down the road but not as long as I thought it was a year ago. That might be something in the future for us to start talking about. Personally I'm comfortable with riding the ride and that is the way we can make our actuarial number.

Warren stated last year we pulled out $2,000,000 to meet the city's obligations. I don't want to leave this amount in cash because we want all the money we can working. I have talked with the ladies and asked that they let me know ahead of time what will be needed for distribution. When we pull that amount out in a lump sum it messes up our allocations. I'll work close with the ladies in finance on what is needed ahead of time.

Warren stated last year we had to pull out $2,000,000 for City of Lawton obligations. I don't want to leave $2,000,000 in cash because we want to have all our money we can working. I have spoke with Financial Services and have asked they let me know ahead of time what they will need. When we pull out $1.6 million it messes up the allocations. I will work close with Financial Services to see they get what they need over the next 6 months.

Ellwanger stated I appreciate you pointing out volatility and what is our appetite to handle that volatility.

Warren asked at what point will ya'll say no. I ask my individual clients to think back to last February. Did you lose any sleep at night? Did you worry if we made the wrong decision? Did you think about those things because of the volatility when you got your February statement? If you had those thoughts let's talk about them now and reduce the volatility so it won't go down. A lot of people in the situation they are in don't want to let off the gas but when they finally do it is after the wreck and not before. The reason we are here is because we are attempting to make the 6.75% over time. I think mathematically we can do it because we are only asking less than 9% from the market. If we make 3% off bonds we are asking 8.36% where the other allocations we are asking 11.5% to 10.5% because bonds are more of a buffer when they pay 5 and 6%. That portion is making the coupon all the way through. Now it is reset and the damping of the volatility is not a 5% return it is a 2 or 3%. That is what it shows here by the aggregate bond. That is the whole bond market.

Hadley stated very good. Are there any other questions or concerns. Anybody want to share their appetite for volatility. It is different for individuals. With my investments I handle those differently than I would these. I don't have decades before I need the money. Thank you.

<u>**Motion** by Hill, **Second** by Ellwanger</u>, to accept the financial report from Morgan Stanley. **Aye**: Ellwanger; Hadley; Hill; Livingston; Bayones; Dentler. **Nay**: None. **Motion Passed**.

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

Johnson stated starting with the balance sheet. At the end of December you see the system had $50,406,690 total assets. There was a little over $724,000 in cash and money market funds. Our total investments are right around $48,000,000. We have $1,640,000 invested in judgments and interest. Account receivables are a little over $149,000. In liabilities we have just under $200,000 in employee refunds and equity position at the end of December was $40,207,040. The second page is the Statement of Revenue and Expenses. Total revenue is a little over $2,007,000. City contributions were not quite $578,000 and employee contributions were a little over $364,000. The rest is income that we either earned and realized or unrealized that makes up the rest of the $2,007,000. We paid out a little over $1,080,000 to plan participants, refunds of $267,866, investments fees of $70,635, bank charges of $93 and consulting fees of $5,510. The refunds are on the next page. For the quarter we had a net increase of a little over $583,000 and year to date is $1,645,671. We didn't do quite as well in the second quarter as we did in the first. Most of the first quarter was in the form of unrealized gain. Do you have any questions?

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

C. Consider Approving payment of two invoices from McAfee & Taft for services rendered to the Pension Trust. – Tim Wilson

Wilson stated I just have one invoice for approval.

Ellwanger asked is it the one for $176.

Wilson stated yes but it isn't the entire amount. Back in August of last year the Board voiced no objection to allowing the Chair to authorize payment for services that was previously authorized by the Board. After the last meeting we received an invoice from McAfee & Taft for $176. Two of the items were for the Board and one was for the City Attorney's office. The Board is responsible for the $88 and $55. This was for the IRS requirements on same sex marriage.

Motion by Ellwanger, **Second** by Bayones, to ratify the action of the Pension Trust Chairperson and authorize payment in the amount of $132. **Aye**: Hill; Livingston; Bayones; Dentler; Ellwanger; Hadley. **Nay**: None. **Motion Passed**.

D. Discuss and take action on whether to recommend the city council adopt an ordinance amending Sections 17-3-4-331, 332, 333, 335, 336, 337, 339, 350, 353, 354 and 355, amending the title of Division 17-3-4, Article 17-3, Chapter 17, Lawton City Code, 2015, closing the city's regular employee retirement system by prohibiting employees hired on or after a future date to be determined in 2017 from participating in the retirement system, amending the title of the retirement system, adding the definition of "contract member" and amending the definitions of "earnings" and "employee," removing unnecessary definitions and updating certain definitions, amending the contribution and funding requirements of the retirement system, limiting participation in the retirement system to employees hired before a future date to be determined in 2017, allowing vested contract members over 62 years of age the option of electing to retire and receive their retirement benefit while remaining employed with the city, prohibiting former employees rehired on or after a future date to be determined in 2017 from participating in the retirement system, requiring four of the seven pension trust commissioners to be employees participating in the retirement system or retirees receiving a monthly pension benefit from the system, adding a “vice-chairperson” officer position to be elected from the pension commissioners, requiring future amendments to the retirement system to first be presented to the pension trust commissioners for review and comment prior to the city council taking action; providing for severability and declaring an effective date. – Tim Wilson

Wilson stated I’ll start at the bottom and work up. First is language requiring that future amendments come before the Pension Trust for review and comments. There are not requirements in the code that this occur. I have just made certain this happened over the last few years. Even if Council does not choose to adopt the defined contribution plan I want this language to be placed in the code so that an ordinance regarding the pension could not be passed without first coming to the Board.

Hadley stated if there was a funding change it would also have to come before the Board. Council is considering and moving towards having future employees become a part of a defined contribution plan as opposed to our defined benefit plan. If and when this happens Council has indicated they will continue to fund this plan at a rate of 6.5% for all future employees and would continue to do so until the plan is 100% funded.

Wilson stated there is also language that says until it is actuarially sound. That doesn’t mean it couldn’t be changed but with the language I have put in the ordinance it would have to come back to this Board for a recommendation.

Hadley stated Council has the right to change this plan but we are adding this language so they can’t do it without at least letting the Board look at it and make a recommendation. This would allow us time to lobby Council and let our voices be heard.

Wilson stated another modification is we have added a vice chair position. This position is in the trust indenture and to mirror the indenture we have added it to the code. We added that 4 of the 7 members are to be either employees or retirees. If this ordinance passes the time will come the Trust will become more important. We want to make sure we have employees that are either under the system or a retiree receiving a benefit from the system.

Bayones stated someone with a vested interest.

Hadley stated correct and not made up of employees that are in the defined contribution plan.

Wilson stated there is language that says if an employee who is under the system now leaves they will not be allowed to rejoin the system.

Hadley stated it is that way now.

Wilson stated contract members are employees hired by the City Council. If a contract employee is 62 years of age they will have the option to retire but remain employed under their contract. They will no longer be able to participate in the pension system. This does not apply to all city employees. It wouldn't be sound for the plan if you allowed to many this option. They would no longer be contributing to the system and this would hurt the system.

Hadley stated they would be drawing from the system and not contributing.

Ellwanger asked those are just individuals that the Council hires.

Hadley stated yes. By code the Council hires 4 positions. They are all contract employees. It is the City Manager, City Attorney, City Clerk and Municipal Judge. Those 4 would qualify if the change goes into effect.

Wilson stated they have to be 62 years of age and vested in the system. As we said we are going to prohibit employees hired after some future date from participating in the system. I do not know what that date will be. Council Committee wanted it as soon as possible and preferred January 1st but that wasn't feasible. Since we have finished the ordinance we will start working closer to OMRF on the defined contribution ordinance. Once it is finalized we will take it to Council.

Hadley stated there were a lot of changes. We have been working on the indenture because there are things that aren't valid anymore or didn't make sense. We are trying to make it all match.

Wilson stated if Council doesn't pass this ordinance there isn't as many changes to be made to the indenture so we decided to do the ordinance first and if it passes then change the indenture.

Ellwanger asked can you highlight a little bit on the funding. How will the City continue to fund this plan.

Hadley stated currently the city contributes 10% of the employee's salary to our defined benefit plan. The employee contributes 6.3%. That will continue to happen. There will be no change for every employee hired prior to this date. For every employee hired after that date those employees will be required to contribute a minimum of 3.5% of their salary to a defined contribution plan and the City will match up to 3.5%. The employee can put in more but the City will only match 3.5%. Currently the City has an obligation of 10% of every employee's salary and in the future that 10% will drop to 3.5%. The City will take that 6.5% savings and continue to deposit that into the current retirement system. The actuary has said this will not harm the system and might actually help us get better a little quicker. This is what the Council Committee directed us to put in the ordinance. The City will continue to provide an amount equal to 6.5% for all future employees at least until it is actuarially sound.

Wilson stated when this went to Council in September Council voted 6 to 2 to authorize staff to move forward. I'll take my attorney hat off and say as an employee I still do not support this. I believe it is a mistake and I told the Council that on the floor.

Ellwanger stated for the existing participants there will be no change in anything. They will see no change.

Hadley stated that is correct except for contract employees and they will see no change unless they choose the new option.

Ellwanger asked will the current participants under this plan be eligible for the new plan.

Wilson stated no.

Hadley stated we do have a 457 plan they are eligible for with no city match.

Livingston asked if I vote for this plan I don't want to feel like I'm endorsing the plan. I don't know how to convey that feeling.

Hadley stated I understand. We dealt with that when we talked about this a few months ago. The motion then was we did not recommend the Council move to a defined contribution but if they did to make certain this plan was funded at 6.5% for a long time.

Livingston asked does it look inevitable.

Hadley stated I'll be really surprised if it doesn't happen.

Wilson stated 2 Council members are against it. At the last Council meeting 5 employees were recognized for 25 years of service. Council commended them for their dedication. I heard a Councilperson make the comment she was still against this change. There is still opposition. We have a new Councilperson and I don't know how they feel. Even if the new Councilperson is against it I still believe it will pass.

Hadley stated even if they got another vote the Mayor would break the tie and I believe it would still pass.

Wilson stated regrettably at the September meeting there were some employees in opposition but not a lot because in theory it didn't affect them.

Hadley stated technically it doesn't but I feel like it affects all of us that are supervisors and trying to recruit good people. I think everybody agrees this is a better plan it is just more costly. Council has indicated that as well. They feel in the long run this will be better for the citizens from a financial point. Is it going to be better if we can't keep employees? Are there any questions about the changes? As far as the motion and how to convey our opposition maybe something like "the Pension Trust does not recommend moving to a defined contribution plan but if you do we ask you continue to ensure that the current plan is adequately funded".

Motion by Hill, **Second** by Livingston, to inform Council that the Pension Trust Authority does not recommend changing to a defined contribution plan but, if the Council moves to do so that they ensure the current plan is adequately funded. **Aye**: Livingston; Bayones; Dentler; Ellwanger; Hadley; Hill. **Nay**: None. **Motion Passed**.

E. Pursuant to Section 307B7, Title 25, Oklahoma Statutes, consider convening in executive session to discuss the medical retirement of Steven Bowen, and take appropriate action in open session as necessary. – Human Resources

<u>**Motion** by Ellwanger, **Second** by Hill</u>, to convene into executive session. **Aye**: Livingston; Bayones; Dentler; Ellwanger; Hadley; Hill. **Nay**: None. **Motion Passed**.

The Authority convened in executive session at 9:55 a.m. and reconvened in regular, open session at 10:05 a.m. Roll call reflected all members present except Kindt.

<u>**Motion** by Dentler, **Second** by Bayones</u>, to continue the medical retirement of Steven Bowen for a non-job related injury and that he be required to report back on an annual basis as to his medical condition until he reaches normal retirement age. **Aye**: Dentler; Ellwanger; Hadley; Hill; Livingston; Bayones. **Nay**: None. **Motion Passed**.

V. Old Business

None

VI. 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 Memo of Information regarding the death of retiree Marion F Donaldson.
B. Consider Memo of Information regarding the death of retiree spouse Christine Mae Christophe.
C. Consider Memo of Information regarding the death of retiree Finis Hand.
D. Consider Memo of Information regarding the death of retiree Floyd Wilson.
E. Consider approval for the paid-in-full judgments to be released from the record.

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

VII. Comments

VIII. Audience Participation

IX. Adjournment

There being no further business the meeting adjourned at 10:10 a.m.

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