

# “So You Have Been Appointed to the Pension/OPEB Board- Now What?”



June 22, 2017

# Question 1

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- What does it mean to be appointed as a fiduciary?
- Who is a fiduciary?

- Administer the Plan in compliance with the Plan document
- Duty of loyalty
- Prudent investor rule
- Diversify investments
- Avoid prohibited transactions

# Duty of Loyalty (Q1- cont.)

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- To act solely in the interests of the Plan's participants and beneficiaries
  
- To act for the exclusive purpose of
  - Providing benefits to participants
  - Paying reasonable expenses

# Prudent Investor Rule (Q1- cont.)

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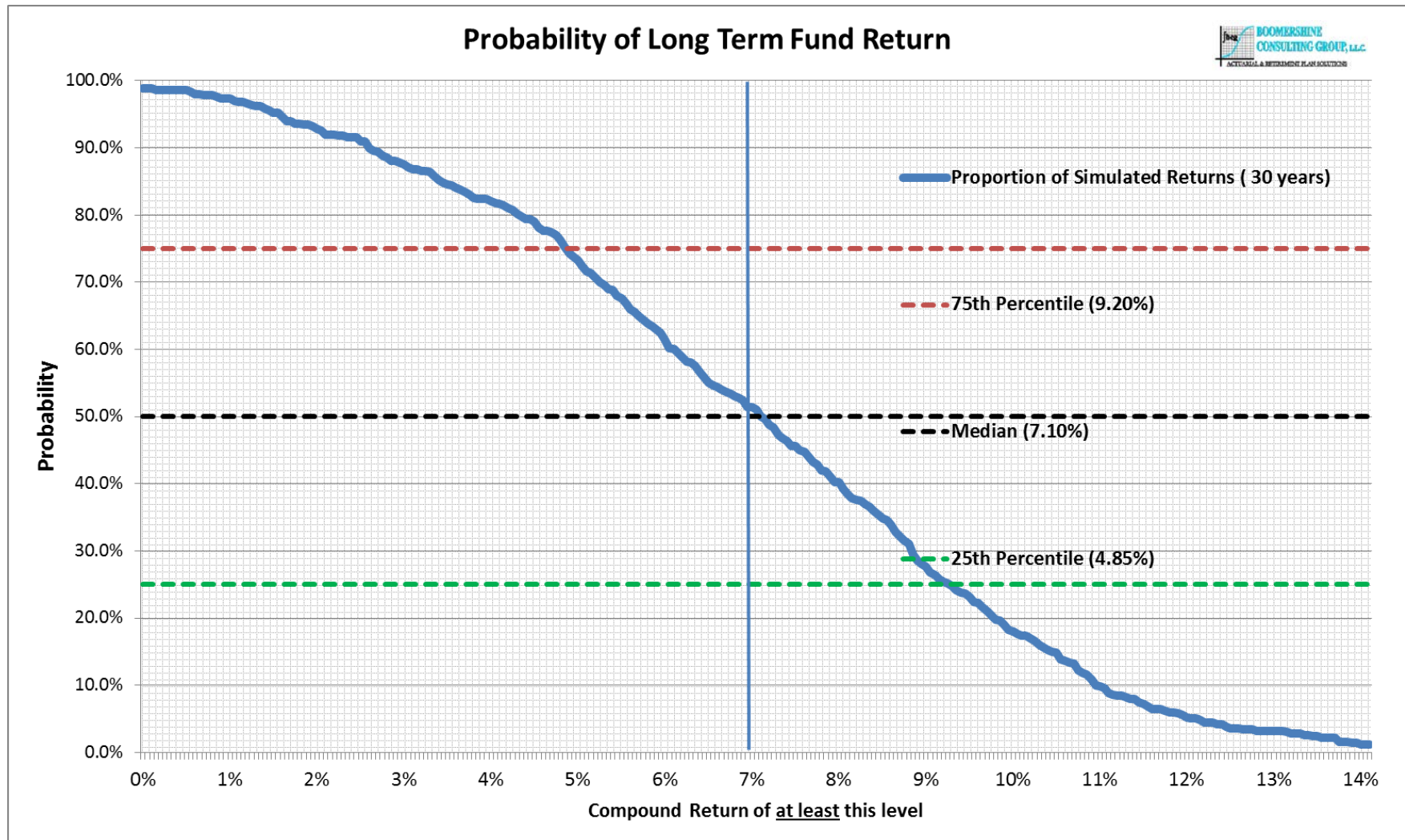
- To act as would a prudent person
  - Acting in a like capacity
  - Familiar with such matters
  
- “... a pure heart and an empty head are not enough”

# Question 2

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- How should a pension or OPEB board think about risk in setting a portfolio allocation?

# Investment Return (Q2- cont.)



Simulated  
Return  
Probabilities

7.00%:  
51.4%

6.75%:  
53.4%

# Question 3

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- Is there a tension between management who might like a higher return assumption and a more aggressive investment portfolio and a retirement board that has to worry about the future livelihood of plan members?



# Question 4

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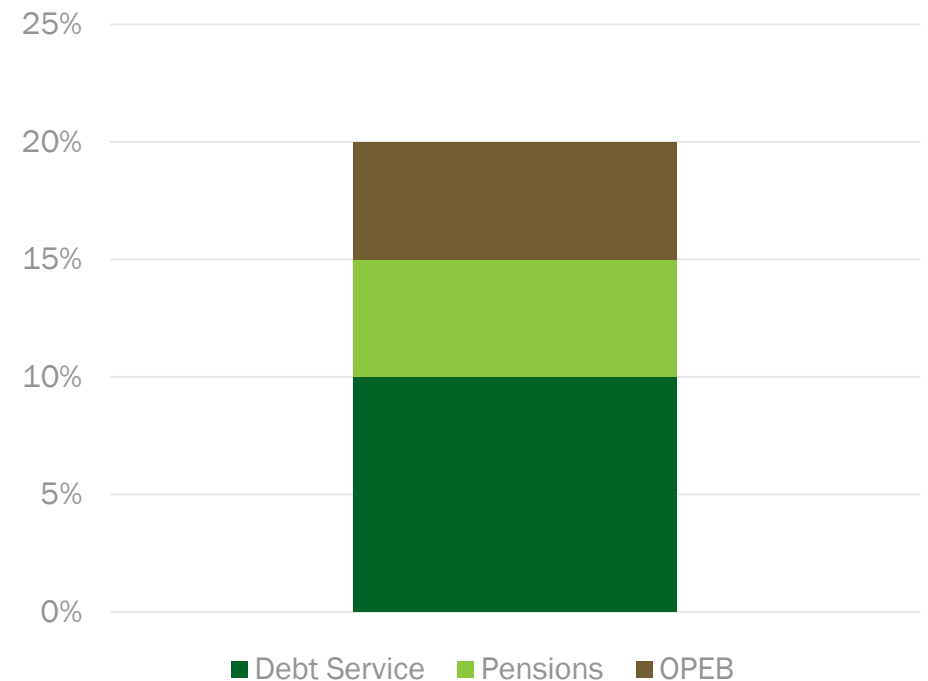
- Staying with rating agencies for the moment, how have their views evolved over the past 10 years or so on pension/OPEB funding?

# Total Fixed Costs (Q4- cont.)

- Rating Agencies are now assessing total fixed costs in terms of budget in order to help determine a government's financial flexibility.
- The higher the fixed costs, the less flexibility a government may have in reducing expenditures if budgetary pressures arise. Outsized fixed costs can negatively effect credit ratings.

$$\text{Total Fixed Costs} = \frac{(\text{Annual Debt Service Payments} + \text{Annual Pension Contribution} + \text{Annual OPEB Contribution})}{\text{Operating Expenditures}}$$

Total Fixed Costs as % of Operating Expenditures



# Question 5

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- Let's get into some information about what a board member needs to know to do his/her job. Briefly, what is an investment policy statement and why is it so important?

- Statement of Purpose
- Roles and Responsibilities
- Standard of Care
- Asset Allocation
- Rebalancing
- Investment Guidelines
- Reporting and Monitoring
- Governance

# Question 6

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- What is the difference between an IPS and an asset allocation?

# Question 6- (cont.)

- The IPS is a tool for managing non-market related risk:
- Political Risk
  - Can help prevent “overhauls of the investment program by various political bodies” - APPFA (Association of Public Pension Fund Auditors).
- Turnover Risk
  - Provides for continuity of process in the face of changing staff, plan professionals and fiduciaries.
- Investment Psychology
  - Provides guidance and perspective to fiduciaries during times of market or political uncertainty.

# Question 7

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- We've talked a bit about duty of loyalty and some of the "dual hat" conflicts or tension that can arise. Let's talk about what it means for a fiduciary to really live by the prudent investor rule. Tell us about the process.

- Prudence is a Process
  - Undertake appropriate analysis
  - Ascertain relevant facts
  - Investigate other options
  - Obtain expert advice, as necessary
  - Utilize prudence in delegating and selecting advisors or agents



- Liability arises from
  - No written policies, guidelines, or selection criteria
  - Lack of understanding of investment
  - Failure to obtain advice
  - Failure to monitor investments

- Liability arises from (continued)
  - Failure to maintain minutes that document the process
  - Unreasonable fees
  - Failure to follow IPS
  - Conflicts of interest

# Question 8

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- To the group at large, why can't we just rely on our advisors to keep us out of trouble?

# Question 9

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- Let's go around when consulting on a pension/OPEB plan or for a local government, who do each of you work for?

# Question 10

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- How does everyone get paid? What is the source of funds? Are there different ways?

# Question 11

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- What are the key results from the actuarial valuation that a fiduciary should be focused on and why?

# Actuarial Valuation – Key Results (Q11- cont.)

- Actuarial liabilities vs. Assets: Funding Ratio
- Unfunded Actuarial Liability (UAL)
- Annual Cost
  - Normal Cost
  - Amortization of UAL
- Past trends
- Projected costs – trends
- Maturity of Plan: Retirees vs. Actives
- Funding basis
- Any significant changes
  - Plan
  - Actuarial basis
- Volatility

# Question 12

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- Investment Performance reports contain a bunch of information. What should a board member focus on?



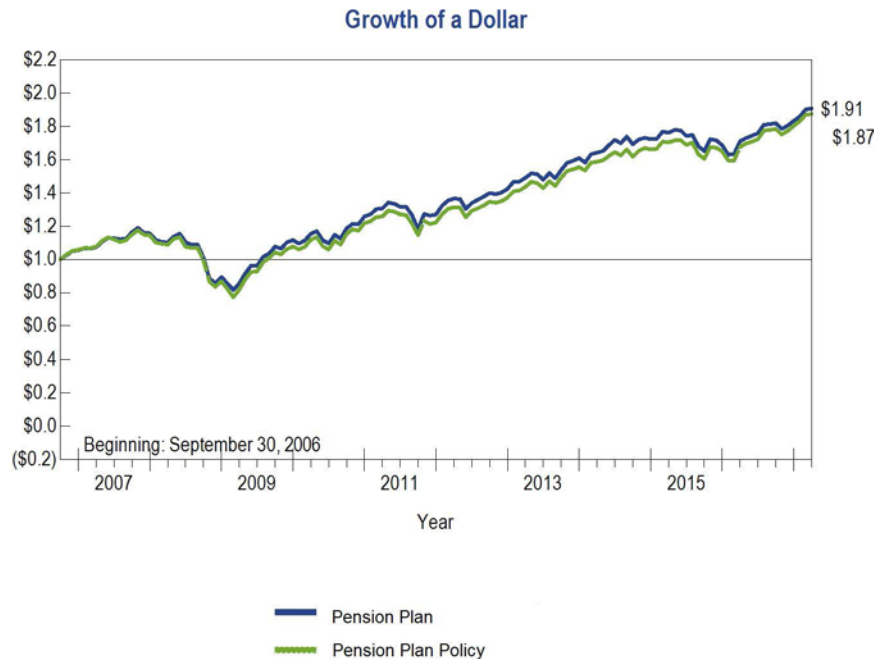
# Investment Performance Analysis (Q12- cont.)



## Total Plan Information

As of March 31, 2017

### RISK RETURN STATISTICS



	Pension Plan	Pension Plan Policy
<b>RETURN SUMMARY STATISTICS</b>		
Number of Periods	126	126
Maximum Return	7.80	7.77
Minimum Return	-12.51	-12.83
Annualized Return	6.49	6.16
Total Return	93.55	87.35
Annualized Excess Return Over Risk Free	5.67	5.34
<b>RISK SUMMARY STATISTICS</b>		
Beta	0.97	1.00
Upside Deviation	5.74	5.87
Downside Deviation	8.16	8.39
<b>RISK/RETURN SUMMARY STATISTICS</b>		
Annualized Standard Deviation	9.91	10.16
Alpha	0.04	0.00
Sharpe Ratio	0.57	0.53
Tracking Error	1.27	0.00
Information Ratio	0.26	--
<b>CORRELATION STATISTICS</b>		
R-Squared	0.98	1.00

The Growth of Dollar graph and the Summary of Cash Flows is net of all expenses whereas the returns presented above are gross of advisory fees. The returns presented herein will be reduced by advisory and other expenses the client may incur.

### Summary Of Cash Flows

	Last Three Months	Fiscal Year-To-Date	One Year	Three Years	Five Years	Seven Years	Ten Years	Inception 10/1/06
Beginning Market Value	\$74,554,347	\$73,352,369	\$71,360,223	\$72,717,118	\$62,457,019	\$53,772,661	\$49,476,648	\$45,567,256
Net Cash Flow	-\$1,109,014	-\$2,957,465	-\$3,031,790	-\$7,519,781	-\$9,981,602	-\$11,292,134	-\$10,905,333	-\$10,360,512
Net Investment Change	\$3,035,136	\$6,085,564	\$8,152,036	\$11,283,132	\$24,005,051	\$33,999,942	\$37,909,153	\$41,273,724
Ending Market Value	\$76,480,468	\$76,480,468	\$76,480,468	\$76,480,468	\$76,480,468	\$76,480,468	\$76,480,468	\$76,480,468

# Question 13

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- If performance is lagging and liability and costs are growing, what can that do to credit ratings?

# Question 14

- It's hard for active managers to beat the index funds these days. Which approach is better?
- What kind of due diligence is required of an index fund?

# Question 15

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- Should a pension or OPEB board have a formal funding policy?

- Policy components
  - Funding progress objectives
  - Cost volatility
  - Minimum contributions
  - Actuarial assumptions/methods, and periodic review of such
  - How to handle extreme events (like 2008)
- This list is NOT all-inclusive
- Need to consider short and long term objectives
- Must be reasonable and enforceable

# Question 16

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- For the group- What kind of conflicts of interest or other ethical considerations should plan fiduciaries know about?

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