Minutes of the Lehigh County Retirement Board Meeting

Lehigh County Government Center Public Hearing Room

Tuesday, August 6, 2019

9:30 A.M.

A meeting of the Lehigh County Employees' Retirement Board was held at 9:30 A.M. in Lehigh County Government Center Public Hearing Room. Members present were Glenn Eckhart, Edward Hozza, Tim Reeves and Edward Sweeney.

Phillips Armstrong, Percy Dougherty and Marty Nothstein was not present.

Kevin Karpuk from Cornerstone Advisors Asset Management also attended.

Glenn Eckhart, Retirement Board Secretary, called the meeting to order at 9:34 A.M.

This meeting is being taped for public record.

## OLD BUSINESS

**Meeting minutes for approval from the May 14, 2019 meeting.**

Glenn Eckhart called for a motion to accept the meeting minutes from the May 14, 2019 meeting.

A motion for approval was called.

Ed Hozza made a motion to approve.

Timothy Reeves seconded the motion.

A voice vote was called.

All were in favor. 4-0 vote. Motion passed unanimously.

## NEW BUSINESS

**Second Quarter Update from Cornerstone**

Kevin Karpuk from Cornerstone gave the Second Quarter review. All in all the pension plan has been doing quite nicely year-to-date through the end of July. It's up over 12.5%. Net Portfolio Performance on page 1 of the handout shows the portfolio returned about 3% which is slightly below its benchmark but grew from $506 million to $514 million which is a nice growth rate. Including pension distributions through the end of yesterday (8/5/19) we closed at just about $501 million. There has been some pull back including distributions.

Asset Allocation (page 2): The pension plan continues to follows an allocation that balances the need to grow the plan into the future with short-term risks. This is not an overly risky portfolio but it does allow for the possibility of hitting the 7.5% actuarial assumption. We do maintain an over weighted United States-based stocks as shown in the 6% over weight mixed domestic equity.

Historical Cash Flow (page 3): Since July 1, 2010 when Cornerstone was retained, there have been about $100 million of contributions to the plan vs. $200 million worth of withdrawals. The income and change in market value show the capital markets have been quite friendly. The plan has grown about $280 million over that time.

Manager Performance (page 4): This is just a list of each of the managers.

Monthly Flash Report (page 5): July was a positive month. August has just started and has been volatile. If you drop to the bottom line, you'll see the portfolio netted fees for the year is up 12.7% vs. a benchmark of 13% so slightly it's slightly behind. This portfolio is booked to hit singles and doubles because in this business you can't swing for the fences and protect when the market gets hairy at the same time. We are quite pleased with the portfolio's performance and the rebound from what was a relatively lackluster 2018 continues.

Glenn Eckhart noted that the slight underweight of the fund is down to 54.8% in equity. While many other counties are probably in the upper 50's and maybe low 60's right now, ours is in the 55% which means we are at lower risk for when the market decreases. In August, that's going to be good comparable to our peers.

Tim Reeves discussed Act 44. One of things we were briefed on by our current actuarial (which is Korn Ferry) there are two factors we look at when we do our actuarial study. One of the things that they call Act 44 vs a 5-year smoothing method as well as our assumed rate of return. In the discussion Act 44 was a method that was created back in 2008 when the market crashed. It was to protect people from having a large contribution because of that big dip in the market and so forth. But historically most actuarials support and most people use more of a 5-year smoothing method which takes your gains and losses in 20% increments over 5 years. Tim is willing to discuss this further if anyone is interested.

We were encouraged by Korn Ferry and the Board made the decision this year to make the switch to go from Act 44 into the 5-year smoothing method. The assumed rate of return at 7 ½% is something we are also considering taking down at some point. We haven't made that decision yet because it would have been too much of an impact on our contribution this year if we made both those decisions. So we only made the one decision to move from Act 44 to the 5-year smoothing method. Then we're going to be considering dropping our assumed rate of return at some point in the future based on what happens with the market.

That's the update to let everybody know that decision has been made. In 2019, our actuary report was done based on using the 5-year smoothing method. The impact that most people want to know is what our funding status is – it did drop us about a percentage point so we went from 87.9% down to 86.5% in doing that. That was the only impact and certainly 86.5% funding status is still a healthy funding status.

Glenn Eckhart stated that as our funding status decreased, the county now has to put more money into the fund. He asked Tim if he had that amount. The county has contribute this year is $13,904,933 which is just shy of $14,000,000.

Carol Barrett asked Tim – The rate you're considering lowering in the future, next year or whatever, is the assumed rate of return? Tim answered yes. So right now you assume 7 ½%? Tim answered that is what our pension policy states, we assume 7 ½%. In your considerations if you assume a lower rate of return that would be trying to be more realistic or less optimistic? Is that what the thinking is? Tim answered that's obviously the thinking. Cornerstone always gives us a look at the future and I don't think that anyone at the current moment thinks that 7 ½% is probably the right number going forward. A lot of other counties have brought their numbers down to 7 ¼% and some even down to 7%. But it does have some impact on the actuarial report, the contributions, etc. It's not a decision you just make and say it sounds like the right number. You have to do it in conjunction with the monetary aspect.

Glenn followed up with I was just at a conference where Korn Ferry did a presentation. The average public fund right now is assuming the rate of 7.38% so that's of all public funds. None of this would cost the employees any money but it would cost the county more money in the future if we reduce the assumed rate of return which would come out of the general fund. This would not affect any of the employees. It will actually affect the county in a negative aspect as far as cash that would have to be paid into the fund.

Ed Sweeney stated that it's also important to make clear that we have a policy as a Board we adopted a policy that says we will not consider a cost of living increase for retirees unless the funding ratio of our pension fund is at 101% or higher. By making a change from 7.5% to 7.25% in addition to the county paying more money, that ratio level for funding goes down. That funding ratio will go down from 86.5% and will move farther away from the 101%. That has always been my problem with the artificial policy by setting that secondary threshold, it creates quite a bit of conflict. It demonstrates how fungible the funding ratio actually is. By policy decisions like going to the smoothing method we reduce that number farther away from the 101% which is the only point in time when a cost of living increase would be considered. By changing the projected discount rate or the expected earnings from 7.5% down to 7.25% it moves farther away from the time when a cost of living increase would be considered for retirees. But at the same time it doesn't change the dollar amount that's in the fund and it actually increases the amount that the county contributes into the fund. The law that the State promulgates is when that funding ratio is 80% or higher, counties could consider a cost of living increase. The reason is, in my opinion, when it gets under 80% there's a lot of adverse impacts on the county as far as borrowing potential and bond rating. So you always keep the needle above 80% and you can make your other adjustments that you need to make by things like smoothing and discount rates to adjust it to whatever degree you want to above the 80% line. That's why I always had a problem with the artificial threshold of 101%.

Mary Hazzard stated her issue is that Ed Sweeney brought forth a motion in January and no one said anything. Regardless what the outcome is, I don't understand why there was a lack of courage to even discuss the motion. Whether you ultimately decide to change the policy or not, in the interest of transparency and making your case, shouldn't there have at least been a motion approved and a discussion?

Glenn answered I believe we're trying to do is protect the fund as a whole – I don't want to speak for anyone else but I'll speak for myself – anytime we are not putting money in that we should be or assuming a rate that we're not getting or using actuarial acrobatics is wrong. We're no longer in the recession that we were ten years ago. That's why we were in Act 44. It's no longer needed. Our actuary told us to get out of Act 44 and use real numbers. At that point, we need to fund a system to last forever for all employees including every single one who works here currently. I understand compound interest pretty well and the more money you have that you can invest the more you will get in return. We want to get closer to 100% and ultimately the goal is to reach 100%. If we can get to 100%, there will be more money to be spread for everybody.

Mary Hazzard replied that certainly as a retiree she is concerned about the integrity of the pension. Her issue was more procedural. Ed was looking for a discussion. He proposed the elimination of the rule so we could have a discussion and then no one seconded to have that discussion. Why was there a lack of courage to even discuss it? As I said, you built your case and I understand. We've been riding high in this market for a very long time. It seems to me that you're seeing it's probably not going to last for too much longer. But, again, why not the transparency and open discussion and building your case for whatever your view is on that role.

Glenn explained that he never stopped Ed from speaking. If you refer back to any of the minutes that are available on line, you will see he has spoken on this issue many times at these meetings. I don't think we hold anybody back from being able to speak or being transparent. All these meetings are being taped and are available on-line so you can see the discussions over the years. The difference between someone making a motion in favor of supporting something that is brought up by someone else may hold someone back from making a motion because it's not the direction that person might want to go. That's why I didn't second that motion. I can't speak for the rest of the Board. I've made my case in public here many times that I think we need to make sure this fund lasts forever for everybody and the more money we have in it now and the closer we get to 100% the better. I think that would be consistent through any of the discussions we have had on this issue.

Tim stated that from his perspective the policy that was voted on by this Board is what everyone supports. If there is some conflict with that policy, perhaps the motion should be to open up the discussion as it relates to the policy and whether in fact we want to reconsider the policy. Otherwise, I think everyone has made it pretty firm that they are in support of the policy. Therefore the policy rules the day. I think using the words not enough courage? I think anyone is willing to have that discussion for sure. I think it's misdirected. It needs to be towards the policy itself and whether in fact the Board supports reopening the policy for discussion.

Glenn stated the County Executive can do that. The previous County Executive, Tom Muller, created a group of five us that sat down and met with this. The group included a retiree; a union member; Tim Reeves, Fiscal Officer; Daniel McCarthy, Director of Administration; and myself. Our solicitor sat in as well. I led the group over a 3-month period of time during which we spent hours discussing everything that pension board does. We spent hours discussing which direction we should go and tried to accommodate all five members. There were issues that were voted on that I didn't support that I ultimately supported the policy because it was set by this policy board. You're not always going to get everything you want. That was a very open policy discussion. There was a lot of time spent on this. These are the things we came up to. The County Executive is the only one able to appoint another board to revisit the policy. I'm the secretary to the pension board I cannot appoint another board to revisit the policy.

Ed Sweeney said I think your word lack of courage is perhaps really fundamental to what the policy is about. The policy keeps people who are elected to public office -- being the Commissioners who sit on this board, the Executive who sits on this board, and the Controller who sits on this board – from needing to vote on whether they support a cost of living increase every three years or whether they do not. When the funding ratio is over 80%, every three years somebody like me as the retiree representative would be able to raise the motion and have an active discussion about whether a cost of living increase should be granted or not granted. The people who sit on this board, most of who are elected officials, would then have to vote either yes or no on that motion. What would happen is they would have to go on record if they support it or they don't. What they've done is put in place a shield basically that says, although we will talk about it every year and bring it up as a perfunctory exercise in order to say that it was considered and not granted.

If you look back in the minutes, the reference very clearly in each of the minutes says because it doesn't comport with the policy we entered into five years ago and because the fund isn't at 101% ratio we actively can't consider the discussion because of our policy position.

Glenn stated since this is not on today's agenda but in January it was on the agenda we're going back around here in a circle. Let's make it clear – every year there is a vote and anyone can make a motion and discuss anything they want. If two people agree to discuss it again in a different way, we can discuss it in a different way. These discussions happen every year and there are discussions. In fact, there was a period of time in which people didn't even know when it was voted on last. So our group said we're going to vote on this every year. Within the law, we only have to vote on it every three years. We actually made it more accessible to talk about this every year which is more than state law tells us we have to do. We can talk that we're trying to avoid a vote but if this is true, why does the policy state we vote on this every year? State law is clear – we only have to vote on it every three years. We're not the ones trying to hide anything. Those were four elected officials who voted for the policy to talk about it every single year. You could have come to these meetings year after year after year and not heard it brought up. In fact, I think there was in my research a four-year period of time before my time on the board that it wasn't even brought up. Violation of state law actually happened. This is long before I was the Controller. Part of the reason I wanted this in the policy is so we never forget -- every year we talk about it. I'd like to end at this point because we're just talking about the same thing.

Edward Hozza brought two motions before the Retirement Board. The first motion being brought to the Retirement Board is based on our fiduciary responsibility to the long-term sustainability of the defined benefit pension plan at Lehigh County. As many of you know, the Pennsylvania Municipal Retirement System, the Pennsylvania School Employee Retirement System also known as PSERS, the prior known as PMRS, and the Pennsylvania State Employee Pension Plans have all been granted permission to create a pension defined contribution hybrid plans for any of their future employees. What the first motion does is ask the Board to retain the Actuarial Firm of Korn Ferry, upon a favorable legal opinion from the law firm of Campbell, Durrant, Beatty, Palombo Miller of Philadelphia. Korn Ferry would conduct an Actuarial Study on the Effect of an additional Third Tier created Defined Contribution Hybrid plan would have on the long-term sustainability of the existing Lehigh County Defined Benefit Pension plan.

In addition, the study would examine the long-term effect on the existing long-term defined benefit contribution plan with a third tier in place with the following potential Lehigh County employment levels: it ranges from 1,500 employees total count up to a potential of 2,500 total employees being employed by Lehigh County.

I would ask for permission to add that in addition Korn Ferry will do a review in 5-year increments for a total of 30 years into the future. I want to emphasize that those employees hired before December 31, 2020 would remain in the current Tier 1 or Tier 2 defined benefit pension plan. Any employee hired after January 1, 2021 would be placed into a new defined contribution hybrid plan. This is only a study. This motion is to ask the Board to approve the actuarial firm to examine the effect of going to a hybrid plan on our existing benefit plan. Do you have any questions?

Glenn asked if Ed had an estimated cost. Ed did not.

Carol Barrett asked who would pay for it, the pension fund? Ed answered yes, the pension fund pays for it. Carol asked, but you don't know how much? Ballpark? Ed answered at least $5,000. You can also add not to exceed $5,000. I can bring back to the Board at the next meeting an exact cost from Korn Ferry. Glenn asked Ed if that's the way he wants to handle it. Ed answered if the rest of the Board wants to handle it to get a definitive cost.

Catharine Roseberry asked if she could make a suggestion. I think first you need to get the legal opinion that you are allowed to set this up. Ed said that was mentioned, Solicitor, upon the legal... Catharine interjected I understand but I believe the County Solicitor has already given an opinion to the County on this issue. Ed said he would like a second opinion. Catharine told him unfortunately the County can only get outside counsel if Solicitor agrees. The Board does not have authority to do this without the County Solicitor's approval. Ed asked how did we do that back in 2009 when Durrant gave approval for the second tier? Catharine answered we did not pay Durrant for that. That was an opinion that was provided to a separate entity that was shared with the County. We did not pay for that opinion. We never hired Campbell Durrant. Ed said but yet the Retirement Board acted on that opinion. Catharine answered, correct.

Glenn said we need to table this if it's going to move forward. Does somebody have a motion to table it? Tim made a motion to table it until we receive a cost. Ed asked Catharine if the Board of Commissioners have the ability then to past retaining Campbell Durrant if you do not give permission. Catharine answered no, the Solicitor must present the request for outside counsel. Ed asked what alternative do we have if the Administration and the Board wish to do differently? Catharine answered the Charter does not permit second opinions unless the Solicitor agrees. Ed said that is one of the issues we all have with Home Rule and solicitors. Thank you for your opinion. Ed Sweeney asked doesn't the Solicitor work at the leisure of the County Executive? Ed Hozza answered, correct. Ed Sweeney said there's your answer of how you handle it. Ed Hozza thanked Mr. Sweeney. Glenn asked Ed Sweeney if he was going to second the motion to table. Ed said no. Catharine asked if we had a second on the motion to start this procedurally for the purpose of the minutes. Glenn answered there was no second so we can just pull it. Ed Hozza asked if we're pulling Korn Ferry or the second for retention of retaining Durrant? Tim answered I was suggesting pulling both at this point until we receive the cost estimate.

No citizen input.

No further business.

Meeting adjourned at 10:07 A.M.

The next Retirement Board meeting is on November 12, 2019 at 9:30 A.M. in the Public Hearing Room.

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Glenn Eckhart, Secretary