SOUTH CENTRAL CONNECTICUT REGIONAL WATER AUTHORITY

PENSION & BENEFIT COMMITTEE

JANUARY 25, 2024

MEETING TRANSCRIPTION

[PENSION & BENEFIT COMMITTEE MEETING BEGINS AT 12:31 P.M.]

Catherine:

Thank you. We have a lot to unpack, so let's try and do this somewhat quickly. As you remember, last September, we talked about doing an RFI or an RFQ or an RFP for services to manage the pension benefits for the RWA. And you may recall that I was a little concerned that we didn't have enough time to get the work done in case we wanted to make a change. I'm sorry I turned that off. I was concerned that we didn't have enough time to get things done before the end of the year if we were going to be making a change. We did put it off until now.

David:

Just a second. Welcome, Kevin. We see you now. Thank you.

Kevin:

Hi. Thank you.

Catherine:

All right, great. What I'd like to try to do today in short order, and Jeff Bauer, from Angell has joined us and he's going to give us a hand in understanding what our current model is and what we propose to do to move forward. Since we're starting this in January, if we end up having to make a change later in the year, we will have enough time if we start it now. So Jeff, do you want to talk about, or can you talk about, and let everybody know, what is our current model? And then we can talk about what the proposal is in terms of how we can address our fiduciary responsibilities.

David:

Not sure at what point, but I move that we go into executive session for the purposes listed, inviting staff here and our consultants here.

Mario:

Second.

Catherine:

Yes. Thank you very much.

David:

And inviting the RPB member.

Mario:

I'll second that motion.

David:

Okay.

Catherine:

No one else did.

Mario:

I did.

Catherine:

Oh, okay. It's been moved and seconded that we go into executive session. All in favor, signify by saying aye.

Committee members:

Aye.

Catherine:

Okay, great. It's unanimous. So we're now in executive session.

[EXECUTIVE SESSION FROM 12:33 P.M. TO 12:59 P.M.]

Jennifer:

Do you want to do the minutes?

Catherine:

Oh yes, we can do that. We'll entertain motion to approve the minutes from the October 26th meeting. Any discussion? Any objections? All in favor? Everybody say aye.

Committee members:

Aye.

Catherine:

That was unanimous. Okay, Steve is here. Great. Hi.

Stephen:

Hello. Good afternoon.

Catherine:

Sorry for the delay.

Stephen:

That's okay.

Catherine:

I'm going to turn over the meeting for the quarterly investment performance report to Steve and his team.

Stephen:

Sounds good. I'm just letting my screen update here.

Catherine:

Thank you.

Stephen:

Jennifer, do you have the presentation on display?

Jennifer:

I do.

Stephen:

Okay, shall we begin?

Catherine:

Yes, please.

Stephen:

Okay, good. Good afternoon everyone and healthy, happy and hopefully profitable 2024. I think in that order, right? Health first. Some [inaudible 00:03:50] profitability if we do what we do can come in the even I guess.

I'll try to go quickly because we're starting late and frankly I did a relatively condensed book today, or we did, anyway because I think it's pretty straightforward at the moment. Market commentary, relatively brief but real. Asset allocation and investment matrices, pretty straightforward and as expected. And then investment results, we will run through those as well.

Please let us know and be vocal, as always, if you would like to discuss something further that we're going over too quickly if you'd like to speed up or if you have questions, comments or concerns anywhere. So let's with that jump in to the market commentary.

We're still beginning with the bond market, right? Because we're still talking about inflation in the background and the bond market is still the main way the markets directly measure inflation. When inflation goes up, rates go up and when inflation goes down, rates go down, et cetera, typically.

What you see here is somewhat amazing. The last time we spoke we were talking about a bond market that hopefully was going to end the year positive and I think you all know by now that in November and December the markets, US foreign bonds all spiked up quite a bit and as you can see in the far right, as measured by the aggregate bond index, which is a little bit longer than we are invested based on your liability matching. But at any rate, benchmark that we use ended up 6% for the year. I want to say the last time we spoke it was down about a percent.

The red dot below that far right bar shows that during calendar year '23 at one point measured this way, the bond market was down 7%. So it was quite the turnaround towards the end of the year when the inflation numbers started to come in a little bit more favorably and when the Fed's started to speak a little more favorably, at least that's been the interpretation and the fact I guess, so we ended up with a positive bond year. We can jump right ahead please.

Similar things happened in the equity market and I didn't say this on a prior slide, but that ends a two-year route in the bond market, the first one in history, back to back two years of difficult fixed income.

What's utterly amazing I think, and again yields are on the vertical axis and time is on the horizontal axis and we often look at the 10-year treasury just to the left of center horizontally. We know that when this all started just over two years ago, December 31, '21, think of that as January of '22, 10 year treasuries at 1.5%. What's utterly amazing and coincidental is the 10-year end of the year at 3.9%, it's exactly the same place it started the year. And if you slide your eye out to the 20 year, virtually the same start and end, and the 30 year actually the same start and end. And even if you go back to the seven-year, 3.9% versus 4% and the five-year 3.8% versus 4%, so although we went much higher during the last calendar year up to where that light gray ends around 5.2% or so, we came right back to the beginning on any longer term bonds.

Short term, if you look at the navy blue in particular, which is where we're now, the Fed is not cut rates. The market's reaction to things the Fed does not have the same control over which are longer than the short rates. The longer rates, the market reacted, the Fed has indicated they're likely going to react with their dot plots that they come out with, but it hasn't happened yet. I don't think the world is expecting it. I know that the world is expecting it soon generally speaking, but the world is expecting rate cuts as this year progresses, all else being equal. Although you did see the GDP number a little bit stronger today than expected, so we'll see.

A lot of talk at the Fed will react in the second half of the year. We think the Fed is likely now watching very closely employment and unemployment rates because those tend to be, if you start to see any weakness there, like inflation, weakness in unemployment can feed on itself and grow rather quickly and it can become a slippery slope at least historically. So we think the Fed will watch that number closely as a signal perhaps as to whether to start their move.

But the curve is now telling us that it's inverted very heavily on the short end and if you kind of interpret the curve, if you start at the five-year rate where it becomes more normally five-year going out longer, if you pulled that short end down, you would expect that short rates should be at least 3.7 or lower and they're actually 5.3. 3.7 or lower would give us an upwardly sloping normal environment curve. So we'll see if we get there, but there's a lot of talk about going to 3.5 or so before the year is over. It seems fast given that it's getting close to February already, but that's what the curve's telling us. That's what the market's telling us and that's what the Fed's indicating. Time will tell. It's still data dependent as we know, but pretty fascinating end to the year from lots of perspectives. We could jump ahead one please.

Stock market. So this is interesting, right? I think you probably all read this in the last week. The equity market measured by the S&P 500 has reached its prior gain almost exactly two years after prior level, excuse me. So we hit this level two years ago, January 3rd of '22 was the prior peak and we hit it this past week. So it took a little bit more than a year to round trip back to breakeven, basically if you were invested. If a dollar was invested the whole time you're back to where you were.

The biggest difference this time, and you'll remember Russ saying in early January of '22, we were saying the market was knowingly expensive. It looked like rates were going up, inflation was on the horizon and the market was 21.4 times earnings. You can see that up the upper right January of '22. Today, although the level is the same, the multiple is 19.5, so the multiples call it 10% lower. How's that possible? That means earnings looking forward, at least earnings at 10% higher.

The rule period now where it looks like this year rates might go down making for a better environment for stocks theoretically and earnings going up, and if that comes true, you're actually 19.5 time would not be historically considered inexpensive by any means, but if the environment is lower rates and higher earnings, it may not be as expensive as that looks.

Under the surface, that's the S&P 500 with these magnificent seven names included in it under the surface the market's about 16 times earnings. So it is relatively rational under the surface. Not saying it's irrational outside of the surface, but it's more expensive when you look at including those names. Makes sense so far? So it's pretty interesting to say the least since we last spoke. I'm probably sounding more animated the last time we spoke because a lot happened. Let's jump ahead please.

What are those magnificent seven and what's happened? So we saw them the last few meetings, Nvidia, Facebook or Meta, Tesla, Amazon, Google, Microsoft, Apple on the left, they all had truly horrific years in '22. That's the kind of apple green there and they all had really fantastic heroic years in '23 from an investment performance perspective and if you were in the seven... There's so much talk about these and they're really dragging the market, they dragged it up in '21, they dragged it down in '22, they pulled it back up in '23. It's interesting how powerful these seven names have become in our market and how maybe warped a little bit even. Not that it's bad, they're great companies, but if you had invested in them the whole time, you lost 46% in '22, you made 111 in '23, what does that equal? That means you made about 14%, you put up with a lot of volatility and you ended up with an average return of compounded it's under 7% a year, to put up with losing basically almost half your money and then having a huge gain.

So it's interesting and it's all over the media, but the reality is you've round tripped and made a little profit at this point and they're great companies. Don't get me wrong, it's just very interesting that such a small number of companies are pulling the market up in down to this degree, but they are because we'll see that in a few minutes. Can we jump ahead please?

What did we learn in the last 90 days? 60 days, I guess it's 90 at this point. We learned an age-old lesson that I think you all know, but I'm going to remind us and when it comes to 401(k) participants, this is our number one educational tool at the moment. This is a 32-year timeframe. You can see 1990 through the end of '22, it doesn't really look different if you go to the end of '23. And what it says is if you were in the S&P the whole time, you made 10.1% a year on average. That doesn't shock anyone, right? We often use 10% as a number, but if you slide it right to the right and I'm going to pick the 75 days, in 32 years, if you missed 75 days in the market, you actually lost money. It's pretty amazing, right? 75 business days, not calendar days, but 75 business days you didn't even make money.

As a matter of fact, if you missed 45 days, you might as well have stayed in bonds the whole time. I could argue that even 30 days you might as well stayed in bonds the whole time.

So the lesson is as the age-old adage, it's time the market not timing the market, right? So a pool of money like this, pensions like this, benefit plans like this, you tend to have a strategy. You, for the most part, stick to your strategy and that's why this institutional money that typically has less emotions than household money tends to actually make these returns of no missed days. But it's a great lesson for everyone, whether you're an institutional investor, personal or anywhere in between. So I thought that was worth bringing up today because of the hockey stick.

It was so easy to be frustrated by mid-year last year. It was so easy to be frustrated by even the end of October last year that oh, we're not making enough money, what's going wrong? And then boom, we got a whole year in the last 60 days of the year. It's not unusual. It actually is more usual than not.

Another way to look at this is in the last 32 years, all of the returns of the market happened in 75 days. 32 years, 75 days made you all of your money. So it is a patience game. So let's jump ahead please. Pretty interesting, isn't it?

This slide's complex for this meeting. I understand and I'm not just meeting doing it remotely without. I'm really going to focus on the left side of it and the left side of it speaks to where you're already tilted having discussions over the year of wanting to have or desire to have some dividend tilt. It should pay off at the moment.

If you look at the box in the bottom left and the left half of the screen, that whole left side, there's dotted green line there and what the dotted green line is basically telling us when the graph is above the dotted green line, you would think growth stocks, a.k.a. tech stocks and or biotech stocks or anything of that ilk are expensive. When it's below the line, value stocks are inexpensive. Look at the box at the bottom, it lays it out here. So if you look at the forward multiples value stocks currently are about 14.9 times earnings. The long-term average is 14.1, so that's what I say, it's not expensive, it's not super cheap either.

Gross stocks historically are 20.9, they're currently 26.5. So relative to one another one would think you'd want to position yourself into value stocks and we are more positioned in a value and or dividend yield stocks than growth stocks. We've got exposures to both here as I'll show you, but we're definitely more positioned there and have been. Now, that's been true for a while now, but eventually, as you can see where growth stocks have been overpriced at long periods of time in history, value stocks have also been overpriced long periods of time in history. These trends don't change overnight, but when they change like they did for a short time last year, it becomes pretty dramatic. Last year being '22, sorry. Let's jump ahead one more. I think I've got one more slide and we'll jump into the numbers.

Inflation, I don't know if this is a tail wagging the dog or I think this is the dog lately, right? This is it. It's all been about inflation the last few years. So what's going on with inflation? Well, the blue graph and numbers in the box, that's consumer price index. That is the number that we see published every month. The read on this chart was November 3.1. It continues to come down and you can see it's straight down in that right-hand graph.

The number the Fed looks at is the PCE, which is personal consumption expenditures, and they like the PCE deflator and the Core PC. They actually like the Core, the very bottom one. So the Fed's seeing these numbers that are running around 3%, 3.2 also. Note that CPI went up to 9%, PCE, I don't even think it ever hit 7%, right in that range. So it's a less volatile number and that's why the Fed likes it.

Now, the Fed's goal, their stated goal is 2%. We are not yet at 2%. There's a lot of talk. It may be very difficult to get to 2% and we're not convinced the Fed won't settle for something less than meaning more than 2%, we will see, but 2% has been the norm since the global financial crisis and you can see that in '08 and '09 when that fat gray bar is there. That rates stayed low since then, unemployment's been lower. But the reality is, over history, and if you look at the headline CPI, the 50-year average is 3.9. The 50-year average of core PCE is 3.3 is 2 the number or was 2 an unusual decade after the financial crisis. Time will tell, but we're not convinced they have to get to 2, 2.2, but we will see.

So hopefully that gives you a little update as to what's happened. Any questions, comments there? Am I going too fast? When you start late you go fast. I think it's human nature. Everyone with us? Yes, no?

Catherine:

Yes.

Stephen:

All right, good. Okay, let's look at the funds. So this is the salary and union plans as if these are 12/31 numbers. They're not a lot different today frankly. As of 12/31, $71,966,460 upper center between the two funds, all invested very little cash and equivalent, some treasuries, but those are showing up in fixed income.

The equity exposures 58.33% in the box in the upper right. Your domestic international exposures about three quarters to one quarter. International markets are still looking inexpensive, but they did have a very good year also. We'll talk about that. And then of the international, the year typical about 80/20 exposure to developed versus emerging.

One thing I want to point out, I think this is important in the box to the right, Russell 3000, this is what the market looks like today. If you scan and look at the holdings of the Russell 3000, it classifies according to Morningstar, 22% value or dividend yielding, 33% Core showing traits of both growth and value but not strongly in either side and 45% growth. This is an unusually high, historically high tilt to growth names. It's created the volatility we talked about and that 45% is where all the magnificent seven great companies are.

What we have done, again with the quest to some dividend yielding, some income, we've tempered that a bit. We have value not enormously higher, but value is four points higher, you're at the bottom right, your 26% value instead of 22, your 31% growth instead of 45. And the difference has gone into the biggest difference is an increase in decor by almost 10 points. So this tempers your volatility, increases your dividend yield and makes sure that we're not overly exposed to just a few names, if that makes sense. You have plenty of exposure to those names, don't get me wrong, but you don't have the exposure that the market has of say 7% to Apple and 7% to Microsoft and 7% to Google. And I'm rounding numbers, but we've broadened that out a bit and we've done that for quite a while now. So that we think is a much more rational approach today even while using a lot of indexing. Let's jump to the next one please.

Your Matrix. So the left side is your benchmark, the center is the actual, the right side is how far off. We're slightly overweight in domestic equities, 1.65% slightly underweight and international. Some of that is, this is 12/31 and we had not rebalanced during the December run up. We're over weighted in bonds. That is because we have a zero waiting in global bonds at the moment still, we have a very lightweight in alternatives and we have a lightweight in global commercial real estate, and we're carrying very little cash because yields are better in bonds.

So it really isn't that material off. It's think about it's about 1% overweight to equities at the end of the day. The others are us moving money within bonds for the most part. And if we jump ahead please.

On the bond side just for a minute, we don't usually show this, but I thought I'd share with you. So one of the things we do, and it's important I think to understand and remember, especially when you see a big piece of bonds here, these bars and down on the lower left to maturities, these are individual securities that you own, not funds, not ETFs, but individual investment grade and/or government or treasury securities that you own in the portfolios that are there to do fees the liabilities of the short term.

So just pick 2027 just randomly. There's 1,750,000 there that year. That is more or less what your actuaries are telling us that we need that year to make the benefit payments for those shorter term liabilities. And the same thing is true, this is one of these is the salary plan. On the next page I believe is the union plan. They don't look that different. The bar are different sizes, but they are uniquely different based on the fact they're actually based on the cashflow needs of each of those entities separately. If they look parallel, it's a coincidence not because we did it that way, we did it based on the liabilities. I think there's some important little look insight. Jump to the next please.

VEBA looks very similar but again less specific on those individual bonds, but your exposures are, I won't read through it again, but we also gave the Russell 3000 in the box to the right. We also gave the exposures plus or minus and they're run relatively parallel from an equity perspective.

And jumping again, your Matrix will show that story, again the benchmark for VEBA, the actual slight higher overweighting to domestic equity, slight higher underweighting international, slight different underweighting to global real estate. That's commercial real estate. So we've been light there purposely, et cetera. So we basically feel it's on target even though some of those underweights are in overweights, it's more or less the exposure. The biggest exposure is the increase to the bonds and the decrease to the global bonds hedge fund type securities and cash.

Again, we don't want to carry cash making very little when we can buy a treasury still making 5% plus. Can you jump ahead please. I think we'll get into, yep, we'll get into the rest results. It's funny, it delays on my screen. It shows up blurry at first and then it clears. I feel like my eyes are...

This is the quarter, so fourth quarter, so this is October, November, December of last calendar year, the pools of money and there's three investment accounts at Morgan Stanley. There's three benefit accounts at Matrix, who is the paying agent, and that's where all money flows into and out of Matrix. You have $76,254,232 at the beginning of the quarter. They were withdrawals out of some benefit payments is another way to look at it. 400, almost $402,000. I'm going along the totals.

There were transfers from Matrix to Morgan Stanley into the salaried union plan, relatively modest based on the totals. Your net invested thus, so simple math left to right, $75,852,312 was the corpus at that timeframe. End of the year at $82,147,000. So the dollar gain in the last 90 days was $6,294,000, 8.38% net and 8.48% gross.

The main number here as we know to worry about is are we earning, I guess what you've told the actuaries and vice versa. They tell us back what we need to earn. That's the goal. 1.69, clearly vastly upward from that.

During that spike up quarter, no surprise in a spike up quarter, we've known each other for a while. Your mid-points are 9.42 and 9.34, so it was a below. Market benchmark quarter, a very much above actuary required rate of return quarter and that's basically because the bond side of things is quite a bit shorter than the bond market, and that little tilt to value stocks over growth stocks.

If we jump further in, we see last calendar year, same figures you started at $72,859,000 and the left side of the totals. $470,000 net came into Matrix. Much of that money transferred up to Morgan Stanley. You can see 301,100 and 95,000 went into the investment accounts. So you net contributed money there. 73,330,000 is thus your simple net corpus or invested amount from one year ago. Same ending value, the 82 million, so 8,817,134 made last year, 12.14 net 12.55 gross.

Here you obviously out in the actuaries in a year like that, the actuary required rate of return is 6.75 or your goal I should call it. So nice year on that basis and that alone would help with the funded status. But then again, depending on the discount rate, the actuaries is used at any given moment of time can counteract that.

The benchmarks there, not surprisingly fall between them, the mid-points or 10.67 for the average stock equally weighted and 15.75 for the market cap weighted if we were much more heavily weighted towards growth and those seven stocks alone, that's the difference between the 10 and the 15. Not surprising, we're in the middle of those. That's much of what we've seen in the last year. We jump ahead to another current timeframe.

Fiscal year. Rochelle's favorite timeframe I think, sorry, Rochelle. 76,352,000 starting last June 1st. So this is less than a year. 623,350 out in benefits. Some of that funded from the Morgan accounts as you can see. Money came out of the Morgan accounts and went down to the Matrix accounts and the transfer column that equals zero. So your corporate invested starting the fiscal year was 75,728,000. That's your net beginning value. Same ending value, the 82,000,000. 6.4 million so far for the fiscal year, 8.53% net 8.76 gross. Again, the actuaries for that stub timeframe, if you will, require 3.94 because again, that's by month for that number of months or seven months.

And then the market indices, again, the individual bonds on the short end slightly behind and with the slight dividend focus, slightly behind on that basis. We jump out a little further now. So that's all good because we're quite a bit ahead of the actuaries at this point in time.

Five years, and I'll spend a few extra minutes on five years. Five years ago the corpus of the various pools of money had the 57,943,000. There have been net payments out of Matrix trust of 3.74 during that timeframe. So you can see that those were funded both via your contributions into Matrix and transfers from Morgan Stanley down below, but they're relatively neutral. There's not a lot added or subtracted from the Morgan accounts into the Matrix accounts. So it's mostly been almost pay as you go. Your annual contributions have come close to paying your benefits.

So your net invested corpus at that point in time, the 57,569,000 same ending value to 82 million. So almost 24.6 million has been made over the last five years. It's a 7.37% net annual rate of return, 7.76 gross.

So I'm going to jump over those bolded numbers for a minute. Obviously it's nice to see the 7.37 for the last five years because that is above the required actuary rate of return for this timeframe, which is ultimately the goal of all of us here.

And you also seeing, not surprising, we get a little longer term where the 7.76 is above the 7.51 midpoint, not surprising and below the 8.09 midpoint and those midpoints are much tighter and we're basically dead in between them, which is we would expect that's us having more dividend yield focus on purpose to soften the down years and also having more value focused.

You'll see if you look in the bottom right over that timeframe, I'm trying to find it, the average value investor was 10.91 and growth was 19.50. So there's still that big gap over that timeframe from growth versus value. So just kind of interesting.

Now I'm going to jump back up to the three set of black numbers. Just trying to help your minds get around, we know, and we've talked about several times over the years, the volatility of the trailing benchmarks, and I picked five years because I'm going to show you eight year numbers, but we don't have all these numbers eight years long, but we have them five years.

So if you looked at the trailing five years at the end of 2020, which was the end of a good year, but that was the beginning of the COVID year, right? It ended up good. It was a very volatile year. I'll just focus on the net number. The net trailing five-year returns were 9.09. Everyone was happy, I think. If you went to 2021, which is a year where the market got a little expensive right before '22 hit, your trailing five-year returns were 9.86. Wow, that's way above what we need, right? Good.

But then one year later, and I think this is where we got a little bit, I don't know, frustrated is the right word, but there was some concern. You take one rough year and it was a rough year, remember because the stock market was down 80, 90%. The bond market was down 13, 14, and all of a sudden your five-year return, this is only one year ago, dropped to 3.82 trailing five years. They're different five years. But just saying when we meet at this meeting five years in a row, we've looked at 3.82 last year, 9.86 the year before and 9.09 the year before.

I'm going to suggest to you now we've got a combination of good years and bad years in here over the last five years. It's been an interesting condensed cycle in an odd way because we've had COVID, we've had money printing, we've had rates going up, rates going down. We've had a lot. We've had global occurrences, still do, but the 7.37 is where that number currently is in between all of those.

My point is much like the patient slide on the 30 tier slide that I showed on the 10.1% return. We all do it, I do it, but I try to temper it. I hope we stay calm and tempered in the worst of times. It's easy to do in the best of times, but the 9.86 is likely too high of an expectation for a pool like this. The 3.82 is clearly too low for a pool like this, but I think our expectation is still the 6.75 and it's positioned so that it should earn the 6.75 over time.

So is this 7.37 better? Sure. Would that be great long-term? Sure. Is that possible long-term? Sure. But I think we're really positioned to make the 6.75 to 7 and you'll see that.

Let's jump to the eight-year number. This is the first time we've had an eight-year number and it's still coming off. It would've been better if we had it a year ago, but we didn't. Eight years ago the fund had 41,761,000 in it. You had a lot of deposits early on. So in the years between 6, 7, 8, right, because it wasn't so much over the last five, but 8,435,000 net deposits came in and those deposits, as you can see, there were more transfers up into the investment accounts than there were down into the Matrix accounts net. So your net corpus invested over the whole time is 50,197,000. The ending value is exact same number, 82,147,000. So the dollar gains, since we've basically met around that timeframe, have been close to 32 million and right now it's after that good, bad, and indifferent. We're not quite, there we're 19 basis points away, but that's not far.

6.56% annualized net and 6.95 gross. Again, and this is the first time we've gone to eight because we've only had seven before.

The mid-points from an investment's perspective are 7.03 and 6.51. So it's nice to see, despite the fact we have a more value orientation, we're almost exactly at the higher midpoint and well above the 6.51 midpoint, so patients would pay off... At this point, if we have a year where we make something in the range of 8 to 8.5% would be at the 6.75. So it's not going to take a miracle to return. And we've been there before when it was seven-year numbers we're within striking distance of being back at the long-term number barring any unforeseen events on the downside. Obviously unforeseen events on the upside take care of themselves, but we're close.

I did the math quickly. We need one year of making something in the eights. Nothing crazy. And with that, I think if you jump ahead, I think we... Oh right, I forgot to bring this up in the beginning. I apologize.

We had spoken at the last meeting about updating the investment policy statement. Maybe you had a conversation about this already?

Catherine:

No, this is next on the agenda. Thank you. We distributed, yes.

At our last meeting, we talked about making a small change to the edits to the investment policy statement, and I really wanted to add some language that would give us some guardrails to when we would consider other financial matters and making a decision as whether or not we were going to go forward towards full funding.

Just quick example, we could have the pension fund fully funded if we put large sums of money in, but then we have to borrow more money for our capital project, so we have to make some decisions as to when it makes sense and when it doesn't make sense to move that money. And so that's what this language is just to sort of give us examples of what those guardrails would be and when we would choose other financial consideration over pushing for full funding. Does anyone have any questions or comments on?

David:

I think the flexibility is important because I think we've realized that when we set the goal originally that there were other things like a pandemic that came in the middle and said, "We've got to do what we can," and we've done a great job keeping as close as we can to the original plan, and we're within years, not decades of, I think we're on the right track and this gives flexibility that we maybe-

Catherine:

Can we just add to actually for the upcoming budget cycle, it's fiscal 25.

David:

Yes, right. You're deciding that now you're putting it together for us.

Stephen:

Could I add a comment too?

Catherine:

Yes.

Stephen:

So the other thing to consider here as a plan approaches a full funded status, then another goal often comes in which is let's keep it there, right? And the larger the plan gets and the closer the plan gets to making bigger payments as a population ages, that becomes a challenge. So the actuary should be here for this discussion, and it doesn't need to be in the document at this point in time. But as you get, necessarily, I should say, as you get to fully funded status and approach it, oftentimes plans will de-risk a little bit or all the way, any combination. Because by de-risking, that means you understand how we're matching the liabilities on the zero to five year liabilities and then partially matching them on the six to 10 year liabilities. Well, some plans will go all fixed because they're fully funded and they'll a hundred percent match the liabilities, and thus, as interest rates move, as markets move, the plan is immunized from those moves.

However, the big trade-off from this, and I think I'm probably speaking to the choir on this, but is that you will not make 6.75% if you do that. So the actuaries would have to do a study to say that it in effect, for practical purposes, at least, not exact at a hundred to a hundred, but in an effect freezes the asset liability mix because we do a portfolio that has the same bond market sensitivity as the liabilities do, it becomes pure LDI driven investing, but LDI driven investing in today's market is not going to make 6.75%.

So I'm not suggesting you go there, but I'm suggesting it's a consideration because getting to a hundred percent can be fleeting depending on the markets and the interest rates. And that's why some plans, frozen plans do this all the time. Active plans, it's more difficult and Jeff Bauer could speak better to this than I can, but that's because you still have actual accruals occurring. So your employees are working today and getting accruals, so there's ongoing servicing costs as you state here.

So just throwing that out there that because you're talking about fully funded and when it happens, unless the plan is de-risked, at the same time, it continues as to be a moving target, and that's okay in a live active plan.

Catherine:

Thank you, Steve. Mario, you had a question?

Mario:

I presume the thought is we get adjusted as far as the target year based on the language you put in here.

Catherine:

I think we're going to have to, yes.

Mario:

Just bring it up hopefully only one year, but it'll be more.

Catherine:

Larry knows what I think about stretch goals.

Mario:

And I agree, but there are other considerations.

Catherine:

I like the holistic goals.

Mario:

Because you don't want to, as you put in here, you don't want to say, "Well, we're going to meet this, we're going to meet this," and then customers suffer and the system suffers and everything else.

Catherine:

Exactly. I think that the point is prudence, but I really wanted to make sure that we had language that gave us the guardrails for when we could be... When could use that flexibility. It's not, "Well, we don't feel like it," should not be a reason. It should be... There are some other operational or capital need or some other reason why this makes sense as opposed to just taking pigeon [inaudible 00:40:24]. Okay.

Mario:

It is too broad was my only concern. Does it make it just, oh, well this year we're not going to meet...

Catherine:

I don't think that's a prudent way to address this. I think we should have a goal. It should be a realistic goal and we should move forward, move toward it with reasonable flexibility. That makes any kind of sense anyway.

David:

I think we'll know more when we have the valuation done. And you know what the mandatory contributions have to be. You get that in February, right? Or March?

Catherine:

We'll get probably the very, very end of February-

David:

So we've got a little bit of time to know that it's going to be one or two years longer or potentially guess that it's one or two years later.

Catherine:

Yes.

David:

I am fine with this for now because it allows us the flexibility.

Catherine:

Okay, thank you. Suzanne or Kevin, did you have any..

Kevin:

No, I agree with it. No, I agree with you, Catherine. I support this. Thank you.

Suzanne:

I guess what I understand is that you're trying to put in here all the caveats or a wide net over the caveats that would prevent us from meeting the 2025 goal to give us that flexibility to do various things about contributing addition dollars or taking more time to fulfill it, correct?

Catherine:

Yes, that's correct. So in other words, putting some parameters around that decision making process so that we're not just making the saying we don't want to make the contribution because we just don't feel like it. There ought to be a good reason and the reason should be within one of these categories.

Suzanne:

Yes. Do you think that the additional contribution is linked to this goal? Meaning because we have this goal, it forces us to have to make additional contributions when we're below the target.

Catherine:

I think the additional contributions is what will push us towards full funding. And I think it makes sense. When the company's finances are such that we can make that contribution we should, because full funding will get us closer, will reduce some of our future obligations and make it easier for the RWA to meet its liabilities going forward. But I've seen in my career too many situations where there aren't prudent reasons for not making that, frankly, I've seen not only not making the additional contributions, but not making the actuarially recommended contribution. And so I want to make sure that we avoid that situation by making our decisions more disciplined and that's what this language is for.

Suzanne:

So I guess my other question is then that why have we made contributions in the past? My understanding is that because we have not met the target and not because we had the pressure of meeting the goal, am I incorrect in that?

David:

Was part of the goal, it was to meet the goal because there was extra money available, management recommended, let's use the extra funds we have at the end of the year to meet the goal in a more extra-

Suzanne:

I understand that, but if we had met our investment target each year, and I understand you don't make it every single year, et cetera, but if we had, would we have still made additional contributions? I'm trying to see if the individual contributions are linked to the performance and the progress toward the goal and whether it's because we're making up for something that is not happening in another piece of the puzzle.

David:

I don't think of the 6.75% we were going to get to fully funded in this timeframe. We were being aggressive at being more aggressive about it. So even if they had made the 6.75, we still would've had to make extra contribution. And Larry had a comment, I think.

Larry:

To that, I'm just going to say we also committed to the credit rating agencies that we were going to be a hundred percent funded by a date certain, and I think it was originally 2023 and we moved it to 2025. And they're fine with that as long as they know you have a plan to reach a hundred percent funding based on reasonableness.

Catherine:

And that you are putting in.

Larry:

And that you are putting money in, which required the additional pension contribution over and above the arc.

Suzanne:

And so now I feel like we've been doing the over and above contribution to the arc and now we're making it kind of a permanent thing, which I'm not entirely comfortable with. That we're saying we will do that whenever we have the opportunity to take the money. We have money available, we will do that to move this forward.

Catherine:

I don't think that I would agree that that we're saying they're going to do this permanently. I think what we're looking for is establishing a realistic goal for full funding and making those additional contributions based upon the financial availability for RWA on an annual basis, but having some flexibility in making those contributions. We now have this date 2025, which is we're not going to make it and it's in our ITS.

David:

But without a $7 million or some-

Catherine:

Even higher [inaudible 00:46:15]

David:

I know it's a very high number.

Catherine:

And in order to meet that goal by 2025, we would have to, sorry, this feedback is driving me crazy. We would have to take money out of our [inaudible 00:46:33] that we should be spending on capital and maybe borrow more money that we don't need or increase rates, which none of those things, in my opinion, make financial sense in order to meet full funding, even if the rating agencies want it, because full funding is not going to move our credit rating to a point where it makes sense to have to borrow more money in order to meet the capital needs.

Stephen:

I'll throw in that as Angel does their... I don't want to predict at all what it's going to say, but you did just make 12 plus percent in the last calendar year. So it might be worthwhile to see what the actuarial summary says as it would be as of now because you're working off one number from a year ago and a year ago is vastly different than where we are now. But again, rates also dropped at year-end. I don't know what impact that's going to have. Sometimes that has a bigger impact than the fact you made 12 plus percent, but it might just be worth looking at that to see how close you actually are. Or did you get closer or further away?

Catherine:

It's a fair point back closer

Stephen:

Just because it's so close.

Mario:

But it's still a number that's going to be too high.

Catherine:

I would think so.

David:

Yes. I'm just thinking that prediction, it's going to be a number that's going to be too high. We don't want to be having nothing left for the construction fund and then have to borrow another $5 million more for that when we could break it up over two or three years instead and still show forward movement.

Catherine:

Do you remain uncomfortable, Suzanne?

Suzanne:

So can I just ask a question? What does it say on number two? What's the rest of number two to achieve a long-term rate of return that meets the assumed actuarial rate of return. Is there more after that?

Catherine:

No.

Suzanne:

So basically our old goal used to say that we're going to achieve this goal by 2025, excluding the ongoing plan, service costs, et cetera, and the market conditions. And to achieve that, a long-term rate of return that meets the assumed actual rate of return, right? That's the piece I think you need to change in my opinion. Because funding this, we're trying to get to fully funded status by both a long rate, a long-term rate of return that meets the actual rate of return and when it does not, and when business conditions allow to provide additional funding.

So that's why I'm not entirely comfortable with it in that first paragraph. I know I might be speaking semantics and I don't want to drag us all down in this whole thing, but when we set this goal, the strategy was to do this through investment management and annual contributions, that's what our policy statement should say.

And if it's not, if it was just through long-term rate of return and now we are seeing that the need to get there is not going to be fulfilled just by an investment rate of return, but has to be coupled by a contribution, then I would just put that together in a statement that says that's how we're pursuing this, is both by achieving the long term rate of return and making. So there might be a third point, I don't know, but it doesn't seem connected to me to the actual goal.

Rochelle:

I think, can I just speak from recalling when this was first put forward, one and two go together, they still go together. The only thing, and Catherine correct me if I'm wrong, that we added is we didn't just want it tie to meeting fully funded by 2025 solely to the market conditions, but to bring in, there could be other factors like what it would take and what the impact would be on rates and other things that we mentioned, but it was, in my mind, it was always a combination of trying to get to that fully funded level, funded level as well as also achieving the actuarial return.

Catherine:

I would agree with that. I don't think that they're necessarily... They're two elements to getting there. It's not just meet your actuarial, well ADC now they call it, meeting the ADC is not going to get us there.

Stephen:

Right. From the time we've been involved, it was always, from day one it was, we're going to put these extra contributions in and our goal is to make this return.

Suzanne:

So this is what I would offer and then again, I'll cut out. Milestone goal is to be fully funded for the pension plans by the end of fiscal year 2025, excluding ongoing plan service costs.

Two, to achieve long-term rate of return that meets assumed actual rate of return subject to prevailing marketing positions.

Three, as business conditions allow blah, blah, blah, blah, blah to add supplementary sources of contributions to aid in achieving the goal.

That's how I would see this written. And again, we could be talking semantics, but that's how I understand what you're saying and I feel like it's clearer.

Mario:

Why don't we do that take you off-line [inaudible 00:52:13]

Suzanne:

I'm happy to move on if nobody else agrees with me.

Stephen:

And I apologize. I arrived late obviously, and I have to meet at 2:00, it's about 15 minutes away, so I'm a little behind.

Catherine:

It's fine.

Mario:

Yes.

Catherine:

We're going to-

Stephen:

Thank you.

Catherine:

We'll take this off the agenda for now and we'll have I guess a special meeting next month just to discuss this.

Rochelle:

Exactly.

Catherine:

Let's tweak the language again and then we'll come back next month. So would everybody to be happy with this?

David:

Okay. That's very good.

Suzanne:

Or Catherine, accept the language and change it at your next meeting, whatever you want to do.

Catherine:

Okay. All right. David, did you have a motion?

David:

I do have just one question. Jennifer, did he leave?

Jennifer:

Who? Steven?

Stephen:

I can leave.

David:

No, no, Steve, that's fine. All right. Kevin left because he had another thing that he had to do with 2:00 o'clock, [inaudible 00:53:17] so we're all here to vote still.

Kevin:

I'm still here.

David:

I move that we adjourn the pension and benefits committee and reconvene as the Authority.

Mario:

Second.

Catherine:

Seconded. All in favor five by saying aye.

Committee members:

Aye.

[PENSION & BENEFIT COMMITTEE MEETING ADJOURNS AT 1:52 P.M.]