South Central Connecticut Regional Water Authority

Pension & Benefit Committee

July 28, 2022

Meeting Transcription

[PENSION & BENEFIT COMMITTEE MEETING BEGINS AT 12:32 P.M.]

David:

All right, Suzanne. It's your meeting.

Suzanne:

Thank you. Good afternoon, everyone. And I trust we have Morgan Stanley on the line as well. My screen isn't big enough to host everybody's face. So I'll move it forward. First, we have the minutes. So I'd like to get a motion to approve the minutes.

Tony:

I move.

Catherine:

Second.

Suzanne:

Thank you. Is there any discussion, any concerns, comments? Okay. Without any, I'll ask for approval. All those in favor. Say aye.

Group:

Aye.

Suzanne:

Opposed? Abstain? Okay. Excellent. All right. We are going to move on to the next item and that is our quarterly performance. So Steve, this is what I'd like to do, actually, if you don't mind. Is let's start with the 401k... And David, if I have to make formal changes to the agenda or Jennifer, let me know. I'd like to-

David:

No, you have authority as chair to move them around.

Suzanne:

Okay. So let's start with the 401k annual update. Is that okay? Or is that difficult for you to spin around?

Suzanne:

I see it's not difficult at all. Okay. So let's start with that and then put that to bed and then we'll go back to performance, then we'll talk about all the other items as well. Okay?

Steve:

Sounds good.

Tony:

Okay.

Suzanne:

Thank you. Welcome. And who from your team is here please?

Larry:

Joe McLaughlin is here to discuss the 401k plan. We also have Alan Kantapin and Matthew Snyder, two of our CFA analysts from our team are on the call today also.

Suzanne:

Okay. Thank you Joe, Alan and-

Tony:

This is Steve. I think we know that.

Suzanne:

Yes I do. Thanks Steve. Okay. So if Joe is going to be doing the 401k, Joe, if you'd begin, that'd be great.

Joe:

I'd be happy to Suzanne. Thank you. And Rochelle, did you want to open with any remarks or do you want me to just dive right into this?

Rochelle:

Oh, well maybe I'll just mention that at January meeting, you might recall that it was determined that there should be a 401k annual update and that's what Joe is going to be presenting this afternoon.

Suzanne:

Thanks, Rochelle. As governance and oversight, there was no mechanism getting the 401k plan to the board. So what the board agreed to is to do this annual update in as part of its governance over this plan. So thank you. Thank you, Rochelle. Thanks, Joe.

Joe:

My pleasure and thank you, Rochelle. Jennifer, if you please move to the... Thank you, right there table of contents. The way we thought it would make sense to structure this meeting is to give you a quick overview of the structure of the 401k investment menu with the assets in each of the various asset classes. We will give you an overview of the 401k plan governance as it's established, and then review the mission for the committee that's made up of members of your management team for the 401k plan, and clearly give any of you the opportunity to ask any questions that you may have. Next slide, please, Jennifer. Sorry, one more if you would. And if you could just resize that a little bit, Jennifer, to see the whole slide. Perfect. Thank you so much.

Joe:

We broke it up into various categories across two pages just to give you a visual reference of the menu. You have three fixed income choices, starting with a stable value fund, which is a cash equivalent vehicle that just pays a rate of interest. That varies, obviously with market rates, you have two bond funds, one that is more what we call an intermediate duration core plus bond. It invests in mostly investment grade types of bonds, governments, corporates, agencies, things of that nature. And then you have a multi-sector bond fund that invests in longer duration, as well as bonds that are outside the US and also bonds that are outside of the investment grade rating. So you have a nice array of fixed income options to choose from. Little under 10 million in assets across those three fixed income asset classes that are represented in your menu.

Joe:

You then have two sets of funds where participants can either use as a core investment option, or they can allocate their entire portfolio to these options. You have a suite of target date funds that are managed by JP Morgan. These are the funds that have time horizons attached to them. So they're branded the 2015, the 2020, 2025 all the way out to, I think the furthest one currently is 2055. And those are the ones that have the glide path associated with them, sometimes referred to as, set it and forget it. These also serve as the default option for your 401k. So any employee who joins the 401k plan and chooses not to make their own investment elections, they're defaulted to the target date fund that most closely lines up with their 65th birthday year.

Joe:

So for instance, someone getting hired today would be defaulted to the 2055 version of those funds, until they chose to make any of their own investment elections. And you can see you have just under 7 million dollars in assets in those suites of funds. You also have risk based allocation funds that you've had for many years in the plan. Those are the conservative, moderate and growth allocation funds that are managed by MFS, Massachusetts Financial services. So again, participants can choose to use one of those as either the core or perhaps the entirety of their 401k investment option, though they would have to choose that as their election. And a little over 4 million in those risk based allocations. So you have two different options for participants that would like some help in the management of their 401k portfolios, either going with the target date version or the risk based version. And on the next page, Jennifer, please go ahead. Yes.

Suzanne:

The, the target date and risk based, are they equity oriented or are they diversified also with some fixed income as well?

Joe:

Every one of them is diversified across all asset classes, Suzanne. The longer vintages, so the 2045, '50, 2055, et cetera, they obviously have higher equity allocations in the 90 some odd percent range. And then as each person gets closer to their 65th birthday and the year that aligns with that. So the 2015, '20, 2025, 2030, et cetera, vintages today, those are the more conservative higher fixed income allocation, lower equity allocations.

Suzanne:

Right. So target date and risk based have all assets classes and fixed income only has fixed income.

Joe:

That's exactly correct. Yeah. And the primary difference between the target date is that they have dynamic asset allocations that follow that glide path. So they start with much higher equity allocations, and over time they migrate to lower equity allocation, higher fixed income as each of those vintages ages, closer to the present. Whereas the MFS risk based allocations, those have more static strategic allocations that are aligned with the levels of risk that the funds are named after. The conservative portfolio tends to be in the 30 to 40% equity range from a strategic allocation standpoint. And it will remain in that range of allocation regardless of where we are in the passage of time. So they're more static in terms of how the portfolios are invested.

Suzanne:

Right. So on the risk based, the conservative will look a lot like what the target will look like in the year before you retire and vice versa for growth, right?

Joe:

For the most part, yes. You're correct. Yeah. So the growth would be more representative of a longer vintage target date. The moderate would be fairly comparable to a mid vintage target date. And the conservative, as you said, would be closer to the retirement age vintages.

Suzanne:

Okay. That's interesting. Thank you. Okay.

Joe:

You're welcome. And then on the next page, we are giving you again, just a visual representation of all of the plan's equity funds that you own. And as you might expect, the largest array of funds and the largest pool of assets are in the suite of domestic equity funds that you own. You can see that across the US large cap asset classes, we have both actively managed and an index fund available for your employees and participants to choose from. And then we have value oriented funds for mid-cap and small-cap, and some growth choices for mid-cap and small-cap as well.

Steve:

Joe. We haven't gone to the next page, if we could do that, please. Thank you.

Joe:

Oh, sorry. On my screen. I can see the equity page.

Steve:

And it just on mine now. Okay.

Steve:

Got it. Thank you.

Joe:

All right. Sure. Yeah. Thanks for pointing that out, Steve, you might have a little lag there. So as you might expect, given the array of funds in just the way investors build portfolios domestically, the highest asset representation in the plan you have about 25 million in your domestic equity funds, and then you have two international funds. One is a developed markets fund that does have some emerging markets exposure in it. And then you have a specific emerging markets fund. And between those two funds representing those asset classes, you have a little over 3 million. And as of the end of June, the plan's total assets, that base was just under 49 million dollars.

Suzanne:

And Joe, they're not making choices of these assets. They're making choices of a risk based tolerance or a target date. And it's automatically in an algorithm picking the stuff, right?

Joe:

No, that's actually not correct, Suzanne. The target date funds are all managed by JP Morgan using their investment managers underneath them.

Suzanne:

Okay.

Joe:

Yes. Participants all have a choice as to how they allocate their funds and they may choose to allocate them in any manner in any combination. So people technically could use a target date fund as part of their portfolio, they could use one of the risk based allocation funds, and then they could use any array of the individual funds that you have. For the most part-

Suzanne:

Oh, I'm sorry. Joe, are you saying that this value small, mid and large and core blend is an alternative to the previous page?

Joe:

That is correct. Yes. These are all individual choices. Yes.

Suzanne:

I see. Okay. Very good. Thank you.

Joe:

Sure. You're welcome.

Tony:

Joe who sits with the new employee and helps them decide what they're doing?

Joe:

We make ourselves available, Tony to provide any guidance or advice the employees may need with their investment decisions.

Tony:

And if they're stupid as I am and choose not to elect it, would you advise them that they should?

Joe:

We do periodically remind employees through communication that we're available to help them. But again, if anyone does not make their own investment elections, they are defaulted to one of those JP Morgan target date funds that corresponds with the closest year to their 65th birthday.

Tony:

Okay.

Suzanne:

It's a good question, Tony. And, and Larry, how do you internally through HR, let people know that this option is available to them and how often Joe, would someone be seeking advice? If they're doing all these individual things, they may be seeking it more regularly than the folks who are in a plug and play, but how is this communicated within the company?

Joe:

Sure. And I'll answer the questions backwards, if you don't mind. The last question you asked was how often? We are available as often as anyone would wish to speak with us. So if they're going through any sort of dynamics in their life that require more frequent consultation with us, we are happy to entertain it and help them as often and, or as frequently as any individual may need. With respect to the broader communication initiatives, it really varies over the course of time, depending on what the goals are. And I guess if you don't mind, if we could work through the next couple of slides and I'll talk more about that topic, if that's okay?

Suzanne:

That's okay. It's actually not a question for you, Joe, it's a question for Larry. Meaning if I went to the average employee in the company who participates in a 401k and said, "Do you know that you have access to a really smart Morgan Stanley team to help you make decisions?" Would they go, "Yeah, I know that and I do that," or yeah, "I know that and I've decided not to do that." Or would they be like, "I have no idea what you're talking about."

Donna:

Yeah. This is Donna. I don't know if you can hear me, but I apologize because I'm sick. But I'll just jump in here. All of our new hires are given promotional materials that tell them exactly that we have an advisor there to help them in the system. We also have an individual who's a benefits' manager who sits down and walks them through that and verbally tells all of our new hires that we have these resources and how to reach [inaudible 00:14:50] as well. And it's also on our HIRS site, which is a system that provides all of the benefit information as well.

Rochelle:

And, and I will also add-

Suzanne:

How about for existing...

Rochelle:

Yeah. I will also add that for existing employees, like Morgan Stanley has actually come on site and that's communicated widely and that's done periodically to give updated information or certain forums like preparing for retirement, so that is communicated to all the employees.

Donna:

Yeah. So we have annual open enrollment and during annual open enrollment, which happens every year that happens over about a two week timeframe. And during that time we also advertise it and talk about it then as well.

Suzanne:

Okay. At some point, Larry, I'd like to know awareness levels from the employees. Not high urgency just would like to know.

Larry:

Okay.

Suzanne:

Thank you. Go ahead, Joe.

Joe:

Thank you, Suzanne. So provide you with an overview of the governance, since you requested this be established. I thought it would, again, just laying it out visually for members of the committee, both new and tenured members. Obviously, the organization is the sponsor of the plan, and if you're not aware, it is a non-ERISA 401k plan so it is not governed by the regulations under the Employee Retirement Income Security Act because of your quasi-governmental status. So just relieves a little bit of the burden, but in terms of the work that we do with you as an organization and with your committee made up from some of the members of your leadership team, we do follow all the best practices of ERISA, so just to make sure that distinction is perfectly clear.

Joe:

So obviously the authority board as the governing body of the organization, you are also the ultimate governing body and responsible for the oversight of the 401k plan. As of January, you are aware that the pension review committee was expanded to include the 401k governance as part of their responsibility. And you have delegated to the members of this committee for all the routine matters that have to do with running the 401k on an ongoing basis. And that committee membership consists of Rochelle and Donna as voting members. And then you have Bernard from the benefits in HR group, who is a non-voting member. And just to draw the distinction as to why that's the case is, our recommendation to all the committees that we work with is that you only have voting members on the committee who are covered by the organization's liability insurance policy, since anyone who is a voting member of a 401k committee, whether it's ERISA or a non-ERISA is going to be considered a fiduciary by virtue of their ability to control and have some discretion over certain matters relating to the plan.

Joe:

So obviously Bernard is very engaged with your employees. He's very engaged as a member of the benefits group at RWA with the 401k plan, so we certainly want him involved in the conversations and certainly soliciting input from him, but because he is not covered by your liability insurance, he's not a voting member. And then naturally we at The Kelliher Corbett Group at Morgan Stanley, we serve as your plan advisors. We do serve contractually in ERISA 321 fashion, which is good for you, even though it's a non-ERISA plan, just states the level of engagement that we have. And as authority board members, we serve as advisors to your internal pension review committee. And then as I mentioned earlier, in response to Suzanne's question, we also serve as advisors to your plan participants with any guidance and advice that they may need in planning for their retirements. If there are no question-

Suzanne:

And Joe show, in the pension review with Rochelle and Donna, and Rochelle and Donna jump in if you have more thorough answer, what matters are you being delegated from the board to review on a regular basis? Just give us an example since this is our first presentation, all board members will know.

Joe:

Sure. And it's actually on the next page, Jennifer, if you want advance to it.

Suzanne:

Okay.

Joe:

And Rochelle and Donna, I'm happy to walk through it. I think it will adequately answer Suzanne's question if you want me to.

Donna:

Yes, please. That'd be great. Thank you.

Rochelle:

Go ahead.

Joe:

Okay. Yes, my pleasure, of course. And I'm going to start in the upper left and work clockwise. And as it says, at the top of this particular page, it is an ongoing process. And for your benefit, you should know that the committee meets with me four times per year. We meet basically in the same sequence as this group does. In the case of the committee internally, we obviously are reviewing the 401k plan. And so the committee itself has had a governance process in place, even though we just formalized it between the board and the committee itself earlier this year. And the governance process, we obviously are involved in the establishment of that. We helped the committee maintain all of its records, keeping minutes of the meetings, obviously educating the committee members. We just earlier this year, went through our latest version of what we call fiduciary training.

Joe:

So all members of the committee are apprised of all the latest best practices, regulatory, legislative matters, things of that nature. So we're always making sure that the committee members are well informed and knowledgeable of their responsibilities and obviously guiding the decision making process. We do have an investment policy statement for the 401k plan that drives the analysis and the decision making process around that. If you look to the upper right, Suzanne, I think this is more directly an answer to your questions. What sort of initiatives does the committee work on an ongoing basis with us? We do reviews of really all areas of the plan. So the plans designed, making sure that it remains a competitive benefit for the organization so you can hire and retain the talent that the organization needs to thrive.

Joe:

Any operational issues or challenges that the plan may have, if there are questions, plan document says this, what does this really mean? How do we handle this particular matter? We advise and consult with the committee on operational issues. We do routine benchmarking of the plan. I talked about benchmarking it from a benefit standpoint, but also benchmarking all the service providers. And that includes benchmarking ourselves as your advisors and consultants. We have a third party that we use to provide benchmarking analysis on our services and the costs associated with our services. And then any time that any vendors may need to be engaged to provide services to the plan, we would get involved in that process as well.

Joe:

Clearly the investments are a big part of the plan. So as we get together each quarter, we have a thorough process that we use to review the investments. Each of the investment options, just like in the pension is compared to various applicable benchmarks. And we always are informing the committee as to how the funds are doing relative to their respective benchmarks over time. We've had to put things on the watch list. We may either remove them from the watch list if they improve or we've made recommendations over the years to remove funds, replace them with alternatives. We've added funds, new funds to the menu where they didn't exist in the past all in an effort to make sure that you're offering a best in class array of options there.

Joe:

Moving to the lower left. This gets back to the employee engagement that we were just discussing. And Donna, I think outlined well, what you're doing internally to promote engagement with your 401k plan and engagement with us as advisors. One of the things that we review periodically with the committee is, all of your plan metrics. So we're looking at things like participation, deferral rates. We're breaking it down by various groups of employees and functions within the organization. What we're trying to do there is obviously understand how your employees are utilizing the plan, but also identify areas where we may drive improvement. So whether it's getting more people to join the plan, whether it's getting them to save more, whether it's getting them to improve their utilization of the plan investments, whatever the case may be.

Joe:

And as was mentioned, as we go through that process each time we review it, we then create initiatives as to what we're going to deliver for education and communication content over the coming 12 months. So it could be direct messages to specific people where we want to try to engage them in particular behavior, whether it's saving more, whether it's increasing their deferrals, joining the plan if they're not in, whatever the case may be. And then we have more global education initiatives as we call them.

Joe:

So that could be us coming on site or these days doing virtual office hours, where we make ourselves available to provide one-on-one consultations. It could be group education that is either specific to our WA employees, which we've done a lot of over the years, or it could be what we refer to as global education. So for instance, your committee members just this morning should have received the-

Joe:

So for instance, your committee members just this morning should have received an email from us about a session that we have coming up in August, and we encourage them to share that invitation with all of your employees so they can engage in a webinar that we're offering to all of our retirement plan clients. So everything that you see on this page, again, it's not necessarily a circular process, but each of these four primary areas are typically covered over the course of a 12 to 18 month window where we're touching on each of these topics and making sure that we're advancing the plan and obviously trying to improve the outcomes for your organization's employees as time moves forward.

Suzanne:

And Joe, do you have any way of reporting back to our committee members employee participation, either in your webinars or contacts that are made to you? Certainly not names of people, but just how often our employees are engaged with you?

Joe:

With respect to the group events that we do, yes. Especially the web-based ones, because people have to register for them. So we do know who is signing up, we do know who is actually logging into the presentation, and for most of them we also know how long they were. They were engaged with the presentation. I will add that Empower also delivers routine education to all Empower 401k participants. They also track the same metrics on those that we do. When we do group meetings on site I don't believe that you've had signup sheets, but that is certainly one way that we can track physical attendance for any meetings that we may deliver in your offices. Then with respect to the one on ones we do, there is a signup sheet that is usually run by someone in the human resources team. So we do know who is signing up and who is attending those meetings as well. So we do have the ability to track, and yes we could report that information back to the committee if that were requested.

Suzanne:

Right. And have the committee come up with some annual metric that you can share with the board that just says, "this is how participative our employees have been in engaging Morgan Stanley services, webinars, et cetera." So I would like to have some sense of the percentage of employees who have made contact with you in any given year.

Suzanne:

So I can get a sense of how effective the communication to them has been in terms of reaching them or not, in which case we would have to probably do better recruitment.

Steve:

I might add to that. It might good to share with the committee the overall participation rate of the plan. How many employees are participating, how many are not, and to what degree, meaning what are the deferral rates within the plan on average [inaudible 00:26:56]

Suzanne:

Yeah. All that information would be very helpful in our annual report.

Joe:

Sure.

Donna:

I do have a...

Suzanne:

Sorry, Donna?

Donna:

Sorry. I don't have much of a voice, I apologize. I do have all that information and I will take that as a takeaway, get that to the board.

Suzanne:

Great. That's great. Because I think this is a very important benefit that we offer our employees both in terms of access to it, the ability to save over time in lieu of our pension program. So we'd like it to be as robust as possible. I do think having been a corporate employee, I'm sure there's very mixed awareness of whether people know they can actually talk to somebody or not, and you guys are terrifically smart and they probably wouldn't have access to someone like you otherwise just out in the world. You guys are an exceptional group, so I'd love to have them take advantage of that if possible.

Suzanne:

I also just want to make sure just from a conflict of interest point of view that our committee members are not clients. Nobody needs to answer that, I just want to make sure they are not so that we don't have any issues there. I don't know that there'd be any other conflict issues arising out of their delegation of their responsibilities for oversight besides that.

Catherine:

Suzanne?

Suzanne:

Yes.

Catherine:

My question has actually been partially answered, but I just want to make sure that there's a mechanism for employees to communicate any concerns or frankly requests that they may want with respect to their investment options. I think the answer is yes, but I just want to make sure that we have an understanding of what that process is.

Suzanne:

So Catherine, just to be clear, you're asking if let's say I'm confused and I don't know what to pick and how to do it, or I don't know how to use the system to go onto the site and pick my selections. I don't really know what the report means with the investment returns. I'm concerned that I've lost a lot of money. All those kinds of things. Where do I go? How do I do it?

Catherine:

Or if I have a particular interest in a type of investment vehicle and I don't see it offered how I might be able to access that. Yes.

Suzanne:

How do I ask if that could be added at some point in the future?

Catherine:

Correct.

Suzanne:

Okay. I'm not sure who would handle that question. Donna, perhaps? I'm sure there are very limited options about adding, but if the committee is delegated the responsibility of making some of those choices how does the committee get informed about anything like that?

Rochelle:

Well, I can also mention I think one of the things that was done a few years ago based on employee input was giving a Roth option. So that would actually be an example.

Catherine:

Great.

Suzanne:

To roll their 401k to a Roth?

Rochelle:

Making that an option.

Suzanne:

As self-directed option?

Joe:

To have the ability to make Roth contributions to the 401k, Suzanne. That was added based on employee feedback several years ago.

Suzanne:

Oh, so they just...

Joe:

Yeah, as an example.

Suzanne:

So they've made self-directed Roth selections. They can take those assets and put them into the 401k?

Joe:

They can make contributions from their salary into the Roth 401k component. So instead of contributing pre-tax to traditional 401k, they could instead make after-tax contributions to Roth so that those contributions then have the opportunity to grow tax free for retirement distributions.

Suzanne:

I'm sorry, and how is that connected to the 401k?

Joe:

That is a feature of your 401k. So everyone has a limit that's subject to section 402(g) of the internal revenue code. So for instance, if I have the number correct, I think the limit for everyone is 19,000 or 19 five this year. Then anyone over 50, as you should be aware, are able to make catch up contributions to bring that total up to about 27,000 a year. Each individual person has the ability to direct their contribution either on a pre-tax basis into what we call traditional 401k, as we all know and have known for decades, or they can steer some or all of that contribution on an after tax basis into Roth 401k which then allows those contributions to grow and be available for distribution at retirement without tax consequence.

Suzanne:

So there's one amount annually. I can do one or the other, or I can split?

Joe:

That's exactly right, yes.

Suzanne:

Okay. So Catherine, I'm not sure if you're following this and are clear you got an answer to your question. If they do put it, and Joe correct me if I'm wrong, put it into the Roth version that is a self-directed entity and they can select whatever choices they want for their plan.

Joe:

Yeah. The investments are exactly the same, the participant is just choosing how much of their annual contribution they would like to direct to either pre-tax or Roth after tax.

Catherine:

What tells me is that there is a mechanism for consideration and response to ideas that come from the employees. So this is a good answer.

Joe:

Yes, you're absolutely right.

Donna:

I just wanted to jump in quickly. I just wanted to jump in. A lot of what Catherine was talking about was about plan design, so whether or not a Roth or a non-Roth is actually part of the plan. All of those decisions in terms design get reviewed on an annualized basis through our process. So if employees feel like, let's say for example, a couple years ago they didn't have Roth. The employee surfaced that as a desire, then that would get reviewed as part of the annual design, it would get surfaced to the committee. The committee would review it, determine, look at best practices, determine if they want to take that into consideration, build it into the plan. That would be a decision that would be made part of the plan design.

Donna:

What is being described right now is really how the plan is being administered and where employees would go. If an employee then has the questions on where do I put my funds and how do I allocate between the investments, they would then just go to our financial advisor, who's on this call, who would advise them where they can split their money. For tax versus the non-taxes, that doesn't change the percentages or anything it's just how the money's being managed on the back end. So hopefully that gives a little bit more clarity to your question, Catherine.

Catherine:

Yes. I mean, you've answered my question which "Is there a mechanism for the committee to be responsive to requests for consideration that come from the employees?" And the answer is yes.

Donna:

Yes.

Suzanne:

As long as those requests aren't individual investments.

Catherine:

Exactly. I'm not saying that just because somebody wants something they get it, I'm saying, "is there a mechanism for considering it". That's all.

Donna:

Yes.

Catherine:

Okay.

Donna:

Yes, there is.

Catherine:

Okay. That's all I'm asking.

Joe:

Yes. I can tell you, Catherine, that we've obviously had the pleasure to serve the organization on the 401k for many years at this point, and historically these items have been brought to the committee for discussion and consideration. All types of items. Some of them, as you say, maybe it might be good for that one person, but not good for the plan as a whole but they're always discussed, considered, and then decisions and actions are taken accordingly. Also, where there have been several questions about people's ability to access the advice and guidance that we provide, just to shed some clarity on that, clearly if they were to go to anyone in the HR department or to your intranet where all of the HR information and benefit information is housed, our contact information is freely available. So they have the ability to access us through internal resources at RWA.

Joe:

If anyone contacts empower and they begin making inquiries about the plan and the conversation is "I need help making investment decisions." The Empower representatives would provide them with our contact information so they would be steered to us that way. Or obviously, people can reach out to us directly if they have already access to our contact information. So there really shouldn't be any impediments to anyone getting the advice that they may seek.

Catherine:

Thank you.

Joe:

You're welcome.

Naomi:

Can I ask one question before we move on? I don't know, whether it's for Donna. Do you know what percentage of the RWA employees are involved in the pension?

Suzanne:

In the 401k?

Naomi:

The 401k yes.

Donna:

I don't have those numbers in front of me currently.

Steve:

Joe, do you know?

Suzanne:

So, Naomi, we've asked that it get included in the annual report metrics about participation.

Naomi:

Okay.

Suzanne:

And participation of using Morgan Stanley services, as well as a part of being a part of the 401k, et cetera. So we'll look to see that in the future.

Naomi:

Okay. Thank you.

Suzanne:

Thank you, it's an excellent question.

Rochelle:

The other thing I would add, so for new employees that are not pension eligible, there is an employer component that is the 401k. So that would be in addition to the additional amount that the employee may want to contribute.

Suzanne:

So the company makes a contribution to the 401k for the employee for new employees? Correct?

Rochelle:

Correct.

Catherine:

Is that a match or is it...

Naomi:

Is that a match? Oh, go ahead. Sorry.

Catherine:

Is that a match?

Rochelle:

No.

Naomi:

Okay.

Rochelle:

No, it's a flat contribution that new employees they're automatically enrolled in the 401k and we make a 4.5% contribution. They are able to contribute additional money over and above that.

Suzanne:

And it's four and a half of their salary?

Rochelle:

Correct.

Suzanne:

Okay. And not total comp, right? Just salary?

Rochelle:

Base pay.

Suzanne:

Base pay, thank you. And Joe, going back to the Roth and the 401k. Once money is selected it goes in, it cannot be then redistributed, correct?

Joe:

Correct. It goes in through one channel or the other, if you will.

Suzanne:

Okay. So the tax consequences can be handled. Lastly, I have a question about performance.

Suzanne:

How would you guys like to report performance? Some of this is very individual based and some of it is plan based. How do you want to report on performance of the 401k assets?

Joe:

As far as the investment performance, Suzanne? Is that what you're asking?

Suzanne:

Yeah.

Joe:

And are you asking about reporting it to you at the board level, or to the committee that we meet with routinely?

Suzanne:

Yeah. On an annual basis having some mechanism that says either you go back to the funds that are the underlining pieces of some of these portfolios that get put together or however you want to do it. There should be some high level performance reporting.

Joe:

Okay. Yeah. We can certainly add that to this presentation as we move forward, and we can follow up with current performance of the plan to add that to this particular presentation if you'd like.

Suzanne:

That'd be great. That'd be great. Okay.

Steve:

Just so the committee knows, that is reviewed at every single regular meeting with the committee.

Suzanne:

Sure, I would imagine it is, it's on this chart somewhere. Very good. I just want to get it up to the annual basis on what would be appropriate on an annual level. It's not a big detail report of everybody and how they're doing, et cetera.

Suzanne:

Any other questions from board members or Naomi? Or any other members listening?

Suzanne:

Okay. Well I think that was a great first report, Joe, so thanks very much for getting us through our first oversight report and we'll look forward to some of the additions going forward. I think we have some metrics on investment performance, some metrics on employee participation and employee access to Morgan Stanley services that we're interested in seeing going forward.

Joe:

Thank you. My pleasure.

Suzanne:

Yep. Okay. So Steve, if you don't mind we'll go back to the quarterly performance update.

Steve:

Yep.

Suzanne:

Thanks very much. I'll turn it over to you.

Steve:

Thank you. And Jennifer, could we... I might be having a lag time on my screen, we'll find out I guess. Jennifer, could you bring that up on the screen? I'm hoping it's [inaudible 00:40:44] over there.

Suzanne:

Yeah. I think you're having a little bit of lag time.

Jennifer:

Okay. It's up now.

Steve:

It's up now. Okay. Give me one second.

Suzanne:

We're on Discussion Outline and Agenda.

Steve:

Yep. This is my Teams issue. Let me go to...

Alan:

Steve, I'm having the same issue. I'm on like a minute delay. It just showed up just now.

Steve:

It just popped up on mine, so we can work with that.

Steve:

Okay. So I think a market commentary is likely in order today, given that we have entered a bear market since we last spoke. Then I think we'll jump to the investment results in the interest of... Are we on a 1:30 stop today?

Suzanne:

I think you should jump to performance in the interest of time after the commentary would be a good idea, and if there's any open issues or other questions people have of some of the other material that you've enclosed we can ask that additionally. That's probably the best way to go. Thank you.

Steve:

Let's jump to the first page in the commentary then. Okay good, I moved with you that time. We always like to look at the S&P, as you know, as a basis for what's going on in the at least domestic equity markets, and frankly it's not a bad basis for the global equity markets. What you'll see is back in January of this year in the upper right, January 3rd, the first business day of the year, we were in a market that was trading at 21.4 times earnings. I think we all know in hindsight, and we talked about this at the time, it was a good time to at least take a rain coat out into your investing world with you and hopefully not need it, but clearly it was needed. By the end of June, the US equity market measured by the S&P had fallen 21%. That's the bad news. It's actually literally a bear market, which I somewhat [inaudible 00:42:21] the definition, because if you're down 19%, that's just a bad market. But when you hit 20, we call it a bear.

Steve:

Really don't get too hung up on the terms I think, but we're down 21% through the end of June, that's the bad news. It's not completely shocking, given how much we were up last year. It is another bear market for us to live through. The last one ended March 23rd and that was the COVID bear market. It was extremely fast. Fastest in history I believe. The good news is you now have valuations in the market that have become more rational, right? Interest rates have gone up. We've been fighting inflation at the fed level and on several other levels, and you're now in a market on June 30th that's 15.9 times forward looking earnings based on the whole S&P.

Steve:

If we jump in a little further, can we jump to the next slide? Yeah. So I'm going to look in this box in the left only, and in the bottom of that box on the left, you'll see S&P 500. We just saw this number at 15.9 times as the current valuation, and to the right bottom of that box that's 97% of its 20 year average. Another way to say that is the broad S&P is now 3% below its 20 year average from valuation perspective using price to earnings. What I find fascinating, and we've talked about this before, the remaining 490 or so stocks is now trading at 13.9 times earnings. Arguably quite a value, at 11% below their 20 year average from a valuation perspective. So we like seeing that.

Steve:

I don't like experiencing what we're experiencing now, obviously. No one does. But it's nice to see that valuations appear to be a lot more rational right now. The top 10 names that we've talked about many times are still at a relatively high valuation, about 18% above their long term value. That's even after this very large correction or bear market that we've had. So good news is there's a lot of value in the broad market, probably in the small mid-cap space or just below those top 10 names. Bad news is it took a pretty big drop to get there. Let's keep jumping forward.

Steve:

If this feels bad, it's because it is bad. And the real thing, and I believe we talked about this a bit the last time, the real reason that this feels so difficult so far this year is the bond market has had no buoyancy. I like to say stocks will be stocks, and I think we all know as investors that we will live through bear markets in our lifetimes. Hopefully we all live long enough to live through multiple bear markets even looking forward, right? Typically when you have a down stock market you have a bond market that's at least stable, if not buoyant. What you got here is you had a stock market that any given day this year was down 9%. Bond market was down 9%. Stock market got to 11%. Bond market got to 11%. So there was no diversification help all the way to 11%. Then the stock market proceeded all the way to 21%.

Steve:

Frankly, the bond market stopped at 11 and has improved dramatically since then. So since the month of June, really starting in June, you got some diversification impact. What this all results in, and this is not your portfolio but it's not horribly far off in a way, right? This is standard. A typical investor, classic investor. 60% in equity, 40% in bonds. All domestic. Down 16.1% in the first six months of this year.

Steve:

That is the worst year since we've been keeping records on the bond market in, I can't see the footnote but I believe it's 1974. So this is the worst start to a year we've had. It's worse than '08. 1976, excuse me. It's worse than '08 when that was the beginning of the financial crisis, and any other period.

Steve:

So if it feels bad right now in this portfolio to you personally, it is. It's a very rough start with inflation coming on, not out of nowhere, not really shocking, but with inflation coming on suddenly this year in big numbers, over 9%, you've got fed raising rates, causing bond values to go down at the same time stock values are going down. Frankly, US and foreign went down about the same with foreign doing a little bit better frankly than US. So it's been a rough start to the year, there's no question. Let's jump forward, please.

Steve:

What's going on in the bond market? Because this is a big factor, right? This is what the fed controls. You can see here, I'm going to just use the middle line here, December 31st, 21. So only seven months ago you had the 10 year treasury. If you look at the 10 year and go straight up 1.5, 2%. Well, by the end of June, it was basically at 3%, and frankly it made it almost to three point a half percent. It is back down to 2.7% today. What the fed's controlling is the far left here, you see the three month number? You see how steep this curve is between three month and one year. You can also see that the one year is already close to 3%, 2.8, the fed raised rates again yesterday and went up to 2.25%. So the market's still anticipating another 50 or 75 basis point move. That's priced in.

Steve:

That's why you saw the fed raise rates yesterday 75 basis points, and what did the markets do? The markets soared yesterday because the market's beginning to believe, and you can see this in the behavior of the longer term bonds, the market's basically I think screaming at us as investors that the fed can only do so much. The fed is already having an impact. You're seeing new home sales slowing. You're seeing existing home sales slowing. You're seeing the price of almost all commodities, lumber is way down, copper is way down. Even gasoline and oil are way down. So it's beginning to look like... And M2 money supply was growing at a very slow rate, which tells us all that if you look forward nine months, if you look forward 12 months, it's very likely

Steve:

If you look forward nine months, if you look forward 12 months, it's very likely that inflation becomes under control. I'm a believer that that's going to happen, that this is transient, the Fed's having a big impact. Sadly, the Fed's only tool when times are too robust, when inflation is strong, when jobs are plentiful like we've been living through, when prices are rising, their tool is blunt, they raise rates. They sell bonds in the marketplace to raise longer term rates. And their goal is to hurt us as consumers. Their goal is to damage us a bit, to increase the rate of unemployment, and thus slow things down.

Steve:

And we believe they're being successful at that. They finally hinted at that yesterday. I was hoping they would be very brave yesterday and only go 50 basis points, but they went 75 with the language that sounded well like somebody that just went 50. So little optimistic looking forward. The other side of this from portfolio perspective, we can now get very respectable yields from the bond portion of your portfolio. We were looking at rates of one and 2% before, we're now looking at rates of four and 5% in the corporate bond market.

Steve:

And Morgan Stanley has made some adjustments already to our forward-looking forecast, but this will have some positive impact on your portfolio going forward, there's no doubt on that, that's virtually factual. Jump one more, please. I won't spend a lot of time in this one, you've seen it many times. The far right column's interesting. If we look at sectors, the tech sector, third from the top on the right, far,

far, right, is now 9% below its 20-year average. Communications services, 13 below their 20-year average. Financials, 15% below their 20-year average.

Steve:

Materials, and this is with an infrastructure bill of a trillion dollars, I believe it is out there, materials, 31% below their 20-year average. And healthcare, 11% below its 20-year average. I might sound excited, I haven't been able to say that in a long time. This was looking very expensive for the longest time. So to me, it's a better opportunity to buy, it's a better opportunity when we're investing newer contributions. And it's a better opportunity, not just for stocks, but it's a better opportunity for bonds as well.

Steve:

All this being said, do we know if it's over yet? And we can jump to the next page. No, we don't know if it's over yet. Actually, our firm officially thinks there could be another leg down before this is over, unclear, time will tell. We think that the markets definitely contracted the multiples that we're paying for, we know that. When rates go up, that multiples contract. It may have over contracted given where rates are, but we're beginning to see now, we expect to see, as you see, companies come out with forwards earning projections lower.

Steve:

Morgan Stanley is currently lower than the rest of Wall Street on our forecast for earnings going forward. If we're right, there could be another leg down. If we're wrong, and I hope we are on that one, maybe it's behind us. I think on January 1st, you knew it was a good idea to wear a rain coat into the market. I believe right now you could flip a coin and it's anyone's guess, and a lot of the pundits are all speaking now, where were they January 1st. But the reality is, it's very tough to know now after this big of a correction.

Steve:

One final thought I'll leave you with. It's an election year. We have a midterm election in November. And since 1950, history doesn't have to repeat itself, but it's a strong statistic, since 1950, in every midyear election, regardless of which party won. I love that, doesn't matter who won, the US equity markets were up 100% of the time 12 months later. Again, we can create new history, I hope we don't, but I think it's a pretty strong magnetic history that-

Suzanne:

So Steve, can I ask you a few questions related to commentary before we get to performance?

Steve:

Absolutely.

Suzanne:

So first off, the cost of money, how is that going to impact valuations over time? If valuations are healthier because they're more realistic now, but the cost of money is going up, how is that going to impact how those two things work together?

Steve:

That has been the material major impact, Suzanne, really because the cost of money went up and the valuations on the most extended companies... It's been a major correction in the tech names, in the biotech names in particular, because when you buy a tech name, you're buying earnings that are 15 years out, 20 years out, sometimes 30 years out. You're investing in future technologies like hydrogen or clean energy, for example. You're buying futures, not present. So when the current rate of interest goes up, it takes the multiples down, and it takes them down more dramatically on companies whose earnings are in the future, it takes them down less dramatically on companies who have earnings today.

Steve:

We don't need to discount those as much because we're getting cash flow like from dividend yielding companies, for example, every year. Pfizer had a great number today, just as an aside. So that's been done. My point earlier was, I think if rates stay where they are now, maybe that's been overdone. Because look, you had rates at three and a half percent or close to it, call it six or eight weeks ago, you're 2.7% today, yet we haven't seen that buoyancy come back in because we're unclear on when the Fed's done. Did that make sense? So I would argue that-

Suzanne:

That makes sense. And you don't think that companies will get more conservative with their investments going forward, or do you think they already are and are waiting to see what the Fed does?

Steve:

Well, operating companies, I think that's what you're asking, you're seeing across the board companies either freezing hiring, reducing hiring, even reducing staff. You're seeing companies cutting expenses. Companies are definitely getting more conservative virtually across the board, with exceptions obviously, but yes, companies are more conservative because companies are looking at inflation themselves. One thing I left out, and it's an important factor, US multinationals get a lot of their earnings, pick Coca-Cola, vast majority of earnings comes from outside the US, US based company.

Steve:

So with a dollar also very strong right now, with a dollar that's strong, that's having a drag. You saw it from Microsoft yesterday, you saw it from Google yesterday. You'll see it from Coke, you'll see it from Apple. But the strong dollar is a drag on US earnings, but it actually should net benefit our foreign holdings.

Suzanne:

And then for the fixed income rates going up, and you showed the short curve for the three to one year time period and the impact that it had on our portfolio, is that just a short-term flip? And again, it depends on what the Fed's going to do, or is that something that we can anticipate that fixed income will start to right itself and become a part of an investment class again?

Steve:

Yeah. At the moment, it's the latter. I think fixed income has righted itself and is definitely part of a real investment class now, not just for safety, but for earnings. Look , if we get into a deep recession, the Fed could be cutting rates six months or a year from now, and that could knock fixed income back out of that class. I'm hoping that doesn't happen. For the moment, I'm kind of giddy over it, frankly. We're buying two-year corporate bonds and getting 4%. I don't mean to sound excited, that wasn't something we could get. Alan does all the trades, we get like, "Oh my God, let's buy those."

Steve:

So that's been fun, frankly, and that's been great to see. The problem now is the curve is flattened a bit. So if you go out to 10 years, seven to 10 years, you're not getting paid anymore to go seven or 10 years than you are two. So the challenge is, you still want to put some money out seven and 10 years because if indeed we do get into a slowdown because of this Fed tightening, we'll want those longer term bonds still being a real part of our portfolio. So a somewhat complex answer, but yes, it's back to an asset class for now. Hopefully we don't get into a steep recession.

Steve:

If the Fed is delicate, as they indicated they just might be, the Fed regained a huge respect for me yesterday, had lost it for months. But yesterday, they gained huge respect I think from a whole street because they did talk a little bit more delicately and it made us realize maybe they won't knock us into a deep recession. And hopefully, they won't. I think the Fed wants a small recession, not a deep one. And actually, in my world, we are in a recession as of now, we just reported negative GDP growth two quarters in a row, that's the classic textbook definition, but it's not deep.

Suzanne:

All right. Thank you. And then when you go through the performance, when you're done with that, let's just talk a little bit about, let's close with the implications to our portfolio of all the stuff you're talking about and what you think is going to be on your mind, going forward as you're investing and how you're going to help us stay buoyed through this process.

Steve:

Certainly let's jump ahead because rather than show you this in the interest of time. And tell me if it does jump ahead and I don't realize it, please.

Steve:

All right. That's perfect. I'm just slight lag. So this is for the salary and union plans, and it's not so much different for the VEBA, but you can see where we're actually invested. So Russell 3000, that's your domestic equities. We benchmarked to 42% and we're just ever so gently above that. Outside the US, this is your non US equities, the all cap equity. We're about 2% below exposure there. We're over exposed to US bonds at the moment, almost 6%. That's a very big overexposure for that. Half of that comes from an underexposure to global bonds, full under exposure. We have nothing there.

Steve:

And the remainder comes from an overexposure in alternatives and under exposure in real estate, and then under exposure in cash. So you can see what we've been thinking. Obviously, there's a bit of an overexposure to bonds there, and bonds have had a wonderful rally. We're looking at stock market so far and July has had a great rally, but bond market has also had a wonderful rally recently. So that's been a safe way for us to participate in the rally. So I think that somewhat tells you what we're thinking or we're thinking it's changing because bonds are rallying unless those rates are coming back down again. Very rapid fire.

Steve:

If you jump ahead two more, and please tell me when the screen is there.

Jennifer:

It should be up.

Steve:

Crossing my fingers. Come on.

Suzanne:

What's on the screen is current indicators, equity valuations.

Steve:

Yeah, I think we went backwards. Can we go forward?

Suzanne:

I think we did go backwards.

Steve:

Yeah. It went backwards.

Steve:

It is popping up here. It's just Teams, Teams, Teams. If there's any chance we can use Zoom, it would be wonderful. The VEBA plan. VEBA plan's very similar. I won't read you them all, but slight overweight to domestic equities, underweight to international equities, overweight to bonds, zero weight to global bonds, and the rest of them are very similar. We could jump again. We'll get to the results. Right here, let me adjust my eyes. This is tough on this small screen. This is the second quarter, very difficult quarter. So I'll go to the third column from the right. Can I read it? I might have to bring it up on my own separate... Because again, with Teams we can't full screen quite as well. One second. I have it separately here.

Steve:

You can probably all read it. Okay. So for the quarter, the salary and union planned were down 7,830,000. One of the biggest numbers we've seen. Feels like we're back in early COVID. That was 9.87%. I'm in the upper right. Net of fees, 9.79 gross. That's the bad news. It obviously did not make the actuary returns for the period. The hidden good news, and it's not great news, but in a relative game, your mid strategic benchmark was down 11.93. And if you were equally weighted, you were down 10.92. Equities, Russell 3000 was down 18%, S&P down 17.5%. I won't read them all.

Steve:

But 9.79, believe it or not, is a very strong outperformance versus the strategic benchmarks. One of the strongest we've seen historically. We started to lag a little bit because we were getting worried at prior meetings, but I hate to make up for all that all at once in a down market, but we do tend to do a little bit better in down markets. And if you jump to the next page, you'll see year to date results. Please tell me when you're there.

Suzanne:

We're there.

Steve:

Okay. You'll see year to date. So this is January 1st through June 30th. I'll again go to those right-hand numbers. 11, 920,000 is a total loss. That's the first and second quarter combined, 14.3 net of all costs, 14.14 before cost. And again, it's the same story. We're obviously in a bear market, not keeping up with the actual rates of return this year, but the strategic benchmark is down 16% so far this year. So we have to, and I hope we feel good about that. I added because so much has happened on the very next page, I added July so far. And as of last week, it wasn't almost over, but now it is and I'll update these numbers for you.

Steve:

July's running rather robustly. You've made back a 1.264 million of that loss in July, which is 1.77 net, 1.80 gross. And what I like seeing, frankly, I'm looking at the strategic benchmarks right here, we beat it by a couple points in the down market. We're now keeping up. You're up 1.80, the strategic benchmark is at 1.77. So it's very difficult and not always going to be accomplished that we actually did much better in the down market and are keeping up in the up market. And if you update this through last night, like I did, I actually give it through 10 minutes ago. You're now up about two and a half million dollars for the month of July. It was 3.26% as of last night, it's closer to about 3.4% I believe right now.

Steve:

So we're not back by any means, but it's making some nice progress back. And you're seeing that in the long-term numbers as well. If you go to the very next page, which is the fiscal year to date, which I know matters for a lot of your reporting, the fiscal year to date is going to show a loss of 4.2 million in the pension, a loss of 5.33 net. The actual numbers will be calculated slightly different, but it will be fractionally be the same. We dollar weight them and time weight them, 4.99 gross. And again, your strategic benchmark there that I don't know if they use or not is 6.69.

Steve:

We go out longer term, trailing 12 months is a similar story. I won't read you all the numbers unless you want me to. I'm going to jump out to see what's happened over five years and we can talk about this for a minute, because I think this is some of the more important things. Over five years, the funds in a combination are up 15.534 million, 4.99 basically, 5% net, 5.37 gross. And you say, "Well, these numbers were above seven the last time we spoke." Rochelle and I had this conversation. Think about this math. If you lose 10%, that happens in a one-year period, when you look at your five-year numbers, it's not quite this simple because of compounds, but you basically, you took 2% a year off your five-year number.

Steve:

Does that make sense to folks you would take? If we had a 10-year number, you'd take 1% a year off your 10-year number or a half a percent a year off your 20-year number. It's why over time, these moves matter less, but still with a six-year track record, which is at the very next slide, it brought the net return, which is what your books report, brought it down to basically 6%. It's probably over 6% as of today, but basically 6% a year annualized for the last six years, which is now currently in the bottom of this market is below the actuary rates of return. It's at or above the strategic benchmarks, but it's below those.

Steve:

So again, I can't do that by six, but let's say you're down 12%, which I think we just said 14, 12% over six years is 2% a year just came off of these long-term numbers. So it's painful no doubt, at the same token as though we all know it's part of investing, no doubt, not to discount it, but I feel like your plans are navigating through here, frankly, as well as they possibly could be doing better than the market benchmarks. But no doubt, it's painful. No doubt we're in it every day as you can I'm sure tell, and no doubt we'll get through it. Is it over yet? We don't know. Did we think something was going to happen? Yes. Do we know when it's over? No. We have a nice reprieve at the moment, at least.

Suzanne:

Steve, just going back to the six-year page and you have 6.75 is the actual return, 6.37 is our actual performance. Which benchmark are you using?

Steve:

Well, there's two midpoints, and the one thing over here, Suzanne, they changed during this timeframe and we're no longer giving you the old benchmark and the new one, but the new benchmark is the 6.36 if it's market cap weighted and 6.03 the midpoints if it's equal weighted.

Suzanne:

Okay. First off, I just want to say thank you for this very detailed explanation. I appreciate all the time and energy you and your team put on reading into the tea leaves and figuring out what's what and trying to anticipate best opportunities to buy in if we have extra equity to do that and to take advantage of fixed income, as it gives us a little pop and helps buoy the portfolio. I think the big question is, as you look at it for six years and you're at 6.37%, and don't take this as a complaint about performance over time. I think the question is, there's a very elaborate process, you guys are very smart, we're working very hard to manage the money, etc.

Suzanne:

We're paying money to have the money managed and we are coming out over time at benchmark. And Tony had asked this question a while ago, and I don't know if it's in his mind again at this point, but why don't you just invest in the index and explain why what we would be experiencing would be markedly different if we just had invested in index along the same time period.

Steve:

Well, couple of things on that front. Good question. One, don't forget that this is the current benchmark, not the benchmark over the last six years. So we're comparing it to apples and oranges here. So I think I'd have to bring in the benchmark we're using in the first three or four years and merge the two to give you the real indication. And I think you'd find it looks a lot better versus the current benchmark, the current benchmark where we worked probably halfway through this, A. B, we do index a lot. As a matter of fact, I'm not going to exact, but roughly 50% of your large cap domestic equities are indexed. And that's a big factor, A.

Steve:

B, there's two things you're trying to do in a portfolio. One is you're trying to be at or better than the benchmark theoretically, but two is you're trying to control risk. And I think we're in one of the steepest down markets that we're in the... I think the toughest down market we've been in together, that COVID was so quick. This is not quick. One thing that I think you see quite clearly is that we are controlling risk very much so while it was my point with July versus the first six months of the year, we went down 2% less during the first six months of the year and then we're up exactly as much in July.

Steve:

So when you're controlling downside risk and still meeting the benchmark, that would give you a high alpha, if that makes sense. So statistically, you'd say that's the holy grail. We're getting to the benchmark with less risk than the benchmark. We could beat the benchmark with more risk than the benchmark, but we're getting to it with less risk. And I think that's the key. Plus, I think you understood my first part, that's not really the benchmark for six years, it's just today's benchmark. We stopped giving you all those benchmarks because it's a lot of data on one page. Did that make sense?

Suzanne:

It does make sense. It's just that at the end of the day, it feels more like we are excellent, I think to your point at managing our portfolio for risk management and we're okay at managing it for performance. And your point will be, "Hey, but you have a target and we're meeting the target and that's fair." And perhaps my expectation is that we exceed given how much effort we put into this.

Steve:

It's fair. And I think that part of it is also the cost factor. So we're very focused on cost and that's a good thing, but the more we focus on cost, the more we index and the more we're going to be at target than above. You only get above target by doing things different than the market. And when you do that, we increase the cost to some degree. So it's a trade off, that's all. But I'm actually happy because if you look at your portfolio statistic, so we have a lower standard deviation, we have a positive alpha, which means for every unit of risk we took, we got a positive return.

Steve:

If you take a unit of risk in the index, you get zero alpha. If you take a unit of risk and get the same return with less volatility, you have a positive alpha. So your portfolio has a positive alpha by design when you see it in the current period. But I don't disagree with you. Look, would it be nice to be a little above it? Sure. And depending on you can look at all different time periods, sometimes you're way above it, sometimes we'll leave below it, but you're right, that's the six-year number.

Joe:

Steve, can I add a comment just with respect to the fixed income side of things? Let's not forget that we are doing some work to match the duration of the portfolio assets with the duration of the portfolio liabilities, and at any given point in time, whether we're measuring a quarter a year or three year or five-year period, we're going to see some natural deviation in the performance of the fixed income portion of the portfolio relative to the fixed income benchmarks that's entirely attributable to the difference in their respective durations,

Steve:

100% true. Because we're also holding liquidity that the benchmarks, not that we're holding, we're holding liquidity so that we can pay out next month pension payroll and the next year's lump sums, etc. So good point, Joe.

Suzanne:

Yep. And it makes sense. And when our portfolio is flagging, that becomes even harder, to maintain the liquidity that you need to because there's less access to put in equity to give it some buoyancy. Any questions or comments from anybody?

Steve:

Did you want me, Suzanne, at all, and I don't know because of the interest of time, I know I had a few questions on ESG, did you want me to answer them?

Suzanne:

Yes, I would like you to. I sent to Steve questions about the SEC and some regulatory steps that they've taken related to ESG. I also wanted to know if they felt like from a bad actor's point of view, if our portfolio, and we talked a little bit about this last time, looked in line with our values related to the fact that we're very environmentally conscious, etc. And so I passed those two pieces of information along that other board members shared. And Steve's provided an article, I hope you read the article, I thought it was very interesting. And I think it is very indicative of the stage in which ESG is in, but I'll turn it to you, Steve, to cover that info.

Steve:

And I'll cover that article very briefly and concisely, I hope. And I also sent you about 90 pages of other materials. Don't worry, we're not going to cover that today, but for those of you that are so inclined, there's a lot of good reading in there. A lot of it is repeat from what you saw previously. The SEC has proposed-

Tony:

You spent a long-time prepping-

Tony:

... a lot of time prepping for the test on this, Steve. I don't understand.

Steve:

I'll be sure to ask you some questions then. What did the SEC propose, Tony? I'm teasing. SEC [inaudible 01:12:20] and proposed disclosures for the investment management industry, okay. So really for money managers, regardless of type. And those disclosures are really divided into three different places. There are some managers, funds, or ETFs who say they have ESG integration. So, that's a very light version. You know, they screen out a few bad actors, let's say, to use your terms. And that is a light disclosure. Then there are other managers, funds, or ETFs that are actually ESG focused. So, they market themselves and they say, "We are an ESG fund that we avoid, I don't know, nuclear and coal and whatever it may be. And we do some proactive things with clean water," for example. Those funds have a higher degree of disclosure requirement in this SEC proposal.

Steve:

And finally, there are managers that are impact based. Impact would say, "Okay, I'm going to buy clean energy only. This manager only does clean energy. This manager only does clean water or water conservation, whatever it may be." That's impact. Those have the highest disclosure under this SEC proposed rule. So these rules aren't for you or me. They're for money managers that do these things in their normal course of business. I love what they're doing because up until now, and even now, someone can say they're doing something, but there's no real standard. Europe has a lot of standards. That's in the paper we sent you. We're just getting going. And this is going to be an iterative approach over a long period of time. So, this at least puts a standard in place so that if we bring a manager into you, in the future, not yet, we can compare them to other managers in the same space.

Steve:

And I think it gives us a good toolkit that when Zoe was with us on the last call from our ESG group, and she was invited today. I told her I didn't think we needed her in the interest, that we had enough agenda today, but we can certainly invite her back in the future; but we've been building our own if you will, but this will help the whole industry have some uniform standards going forward. And it's far from done, far from done. And Suzanne, the second question was, what if you or us or somebody identifies a bad actor in something that we already own? I sent a memo back, but basically the nutshell of it is, A- we don't have control. The way the portfolio structured today, there's no control to eliminate a single bad actor.We could eliminate that manager or that vehicle from the portfolios. We could say, let's not pick on any company, but the Evil Empire Chemical Company has polluted the Mississippi River. And we can look through the holdings, as you saw, and see do we own any Evil Empire Chemical Company. And if we do, we could talk to that manager. Are they eliminating it? Have they already eliminated it? Do they plan to eliminate it? And if not, we could eliminate the manager. That's has it structured today.

Steve:

Going forward, there's multiple ways to structure this. We haven't gotten to the point yet where you as a committee or a board have come to us and said, "We want to implement this level of ESG." And I think we'll probably talk more over that over time, but if we had integrated it, we could already say, "We don't want certain types of chemical companies." There are like 70 different screens we could put on every manager to do that, we could do it in a light version, kind of what we talked about the last time and just have some ESG focused funds, ETFs and managers. We could do it in a full version where the whole portfolio goes to all individual securities, and we can put any screens on that we want. We can actually go right down to a company level saying, "We don't want to own Evil Empire Chemical Company," so I don't pick on a real company. And we could exclude that from the portfolios, both on the stock and bond side that is involved. It is definitely can be done. Would have to price it size.

Steve:

I don't think we're there yet. You could tell me if I'm wrong, I just want you know it can be done. That's the holy grail. That's where the world's heading to, but it's by no means there. You'd be out on the leading, leading, sometimes bleeding edge today on that. And finally, and I like this one person. I feel this is a personal opinion, not a recommendation. You could go with impact. You could say, "You know what, several of us like the idea of doing something positive in the portfolio, but we don't want to start affecting price and performance too much because this thing has to meet its goals." That's why we're all here. So, you could do something small and you could say, "You know what? Our organization is very focused on the conservation of water and clean water." And we could literally buy an equity manager, sleeve, fund, ETF, whatever it may be, that focuses on water conservation, that focuses on clean water or some combination of them and that it aligns extremely closely to your your organization's stated goals. So, that could be done.

Steve:

If we did that look at, would that be additive to the portfolio? It could be, and at times it would be. Would it ever subtract from the portfolio's results? At times it could be and would be. It depends. We'd monitor it like we monitor every other investment and how it's was doing. Would we do it in a large manner? I wouldn't recommend that. We wouldn't recommend that. We'd recommend it a small portion of the equity money, probably domestic, to go into that space to say, "Let's have a little impact with our money and invest in this particular space." So, that's a parting thought for today that there are small things you could do, again, to be iterative in the process and have a positive impact in something that's near and dear to your heart's period. How's that?

Suzanne:

Great. Thank you, Steve. I appreciate that and I appreciate all the reading material. And I hope that everybody takes some time to read it because I think it really tells you a lot about the complexity of trying to do this and do it well. And it's always good to appreciate those things.

Steve:

I'll leave you something very simple, even though I said period. Draw a triangle, If you have a pen in front of you. And on the triangle on one point, you could put performance. I like calling it results, but on the other point, you could put costs. And at the other point, you could put ESG factors. The holy grail would be to get that to be a, what is it called? An equal triangle? I don't remember, isosceles. An equal triangle. Yet, those can intend to pull in different directions. So, we can make it all custom and go heavy ESG. It absolutely increases cost a bit today. It may or may not degradate from performance. It's a push and pull between those three factors in my mind, just to simplify it a bit.

Suzanne:

Terrific. Thank you very much.

David:

Suzanne, just as one comment. I greatly appreciate and did read all 90 pages except the 17 pages that were disclosures at the end, but I am comforted that we have no more than, I think it was 1.4 to 3.1% of some of our investments might be in less than ideal companies, strictly from an overview look. So pretty much, we're not investing in companies that we don't want to be invested in. And we hadn't looked at this from that point of view, at least not as a group before, and I think that's important. So, I think that was an important step and a peace of mind step. And where we go from here, we'll see what Suzanne has in mind with you and the committee.

Steve:

Sounds good.

Catherine:

I just wanted to say, thank you for your comments. I found the Barron article, as I often do, a little harsh, but-

Steve:

Yep.

Catherine:

... I am encouraged by the SEC finally starting to establish some standards so that we can compare apples to apples. And it would be much more helpful with respect to looking at these types of investment vehicles.

Steve:

I could not agree more because we're a little bit in the Wild West until there's some standards.

Catherine:

Yes.

Steve:

And Wall Street, I'm part of Wall Street, but Wall Street, I have this somewhat jaundice eye perhaps, but some of these products are more expensive. They don't necessarily need to be. And I sometimes get a little sarcastic. Is that why it's being pushed by Wall Street so much because there's more revenue in it at the moment? I don't think there should be more revenue in it.

Catherine:

Well, I think that there was also an interest from certain segments of the investment community. And since there was money being thrown this way, products were developed without as much thought as we would like. Nicest way I can put it.

Suzanne:

I think that's fair. Yeah.

Catherine:

Yeah.

Steve:

I think this is good. I think at least our goal here is try and get everyone educated and up to the same place. I think when you get there, you realize it's not yet the holy grail that we're looking for, but there are steps in the right direction.

Catherine:

Yep.

Suzanne:

Okay. I guess, I just would conclude with as you go forward, the really important thing for us is to continue, I know we're going to have our up years and our down years, but is to continue over time to continue to meet our metrics. And it's really hard if any one year gets slammed like this, because it's a big deal for our contributions and our abilities to pay out on our liabilities. And once that drag comes on the portfolio, rebounding is always that much harder. We look forward to seeing what you have to offer next quarter and what our market and Fed does to help support all of us as investors.

Steve:

Agreed.

Donna:

Suzanne, this is Donna. I just wanted to let you know-

Suzanne:

Yes, Donna.

Donna:

I just wanted to let you know that I was able to look into the numbers and we've got 91% 401(k) participation and 53-

Suzanne:

Oh, that's excellent.

Donna:

... and 53 pension eligible.

Suzanne:

Very good. Naomi, did you hear that?

Donna:

91 and 53.

Naomi:

Yes. I did. Thank you.

Suzanne:

Great. Thank you. Thank you very much, Donna.

Steve:

Donna, as an outsider here, if you worked for us, you'd be getting employee of the week if not month.

Suzanne:

Yeah. Every excuse not to be here, but here she is. Thank you. Donna. I really appreciate that. All right. Anything else for our teammates at Morgan Stanley? All right. Very good. Thanks. Very much, guys.

Steve:

Much appreciated.

Suzanne:

Have a great afternoon.

Steve:

Thanks guys.

Tony:

Thank you.

Steve:

You're welcome.

David:

Thank you.

Suzanne:

Stay cool.

Steve:

Take care.

Suzanne:

Okay. So, that concludes the Pension and Benefits Committee, unless there's anything else anybody else has on their mind.

David:

Then I'll move. We adjourn and reconvene as the Authority.

Suzanne:

Thank you. Is there a second?

Tony:

This is [inaudible 01:23:47] Tony.

Suzanne:

Catherine or Tony, would you second that motion?

Tony:

Second. Sorry.

Suzanne:

Thank you. That's okay. And all those in favor.

Group:

Aye.

Suzanne:

Thank you. All those against? Abstained. We are now recessed as the Pension and Benefits Committee. Thanks very much for listening. I know it went long as usual and-