

**BOARD OF PENSIONS AND RETIREMENT
FISCAL YEAR 2015 BUDGET TESTIMONY
April 1, 2014**

EXECUTIVE SUMMARY

DEPARTMENT MISSION AND FUNCTION

- The Board of Pensions and Retirement was charged under the Philadelphia Home Rule Charter with the creation and maintenance of an actuarially sound Retirement System providing benefits for all City employees. The Board, as defined in the Home Rule Charter, is composed of the Director of Finance, who serves as Chairperson, the Managing Director, the City Solicitor, the Personnel Director, the City Controller and four members who are elected by the Civil Service employees of the City of Philadelphia and a non-voting member appointed by the President of City Council.
- The major role of the Board is that of “trustee”, to ensure that the Retirement System remains actuarially and financially sound for the benefit of current and future recipients.
- The Pension Board staff administers the day-to-day activities of the Retirement System, providing services to over 64,000 members.
- It is the short and long term goal of the Board of Pensions to continue to provide education and improved services to its members and to execute its fiduciary duty to help ensure the long term viability of the Fund.

PROPOSED BUDGET HIGHLIGHTS/FUNDING REQUEST

- The Board of Pensions and retirement has submitted a budget request for fiscal year 2015 for \$8,776,000 which is the same amount that was requested for fiscal year 2014.
- Employee compensation for Class 100, Personnel Services is \$3,881,000 and there is another \$2,800,000 for Fringe Benefits. The budget also includes Class 200 Purchase of Services for \$1,832,000, Class 300 Material and Supplies for \$125,000, Class 400 for Equipment for \$13,000, and Class 800 Payments to Other Funds for \$125,000.
- Implementation of our workflow management program has resulted in the elimination of overtime the last several years; while increasing productivity measured by the decreased time it takes to obtain an appointment.
- The Fund’s actuary reduced the assumption used for our administrative expenses based on actual experience.
- Ongoing management challenges include harnessing the advanced technology in the marketplace to create further efficiencies for our employees to utilize. The burgeoning availability of forms on our web site that are commonly used by members, along with the ability to complete retirement via mail, are examples of using technology and/or alternatives to the traditional counselor appointment to provide additional options for our members and increase efficiency.

**Board of Pensions and Retirement
BUDGET SUMMARY AND OTHER BUDGET DRIVERS**

Financial Summary by Class - General Fund

	Fiscal 2013 Actual Obligations	Fiscal 2014 Original Appropriations	Fiscal 2014 Estimated Obligations	Fiscal 2015 Proposed Appropriations	Difference FY14 - FY15
Class 100 - Employee Compensation	\$6,450,239	\$6,681,000	\$6,681,000	\$6,681,000	\$0
Class 200 - Purchase of Services	\$1,859,622	\$1,832,000	\$1,832,000	\$1,832,000	\$0
Class 300 - Materials and Supplies	\$70,683	\$125,000	\$125,000	\$125,000	\$0
Class 400 - Equipment	\$4,777	\$13,000	\$13,000	\$13,000	\$0
Class 500 - Contributions	\$0	\$0	\$0	\$0	\$0
Class 700 - Debt Service	\$0	\$0	\$0	\$0	\$0
Class 800 - Payment to Other Funds	\$179,565	\$125,000	\$125,000	\$125,000	\$0
Class 900 - Advances/Misc. Payments	\$0	\$0	\$0	\$0	\$0
TOTAL	\$8,564,886	\$8,776,000	\$8,776,000	\$8,776,000	\$0

Staff Demographics Summary*

	Total	Minority	White	Female
Full-Time Staff	61	66%	34%	79%
Executive Staff	7	71%	29%	57%
Average Salary - Executive Staff	\$105,672	\$94,734	\$121,121	\$79,993
Median Salary - Executive Staff	\$95,000	\$95,000	\$101,988	\$75,057

Employment Levels*

	Budgeted	Approved	Filled
Full-Time Positions	77	77	61
Part-Time Positions	0	0	0
Executive Positions	7	7	7

Contracts Summary*

	FY09	FY10	FY11	FY12	FY13	FY14*
Total amount of contracts	\$28,905,240	\$31,026,354	\$32,546,075	\$27,410,231	\$29,890,980	\$7,083,013
Total amount to M/W/DBE	\$4,419,611	\$3,372,233	\$4,216,549	\$2,560,146	\$3,939,110	\$1,250,478
Participation Rate	15%	11%	13%	9%	13%	17.65%

**As of December 2013*

Board of Pensions & Retirement

PERFORMANCE, CHALLENGES AND INITIATIVES

DEPARTMENT PERFORMANCE (OPERATIONS)

- The Pension Board staff is an efficient and professional group of individuals. One of the measures we use is the administrative cost per member to perform our duties. The most recent data available shows that through March 17, 2014, our cost to administer the plan is \$94 per member. Although the previous annual cost figures decreased from prior years, the \$94 cost is the lowest we've seen since adopting the measurement.
- An additional measure we use is the time it takes an individual to obtain an appointment with a counselor. Since implementation of a more coordinated scheduling process, the time has reduced considerably, from more than four weeks to often less than two weeks.
- The availability of the counselors also improved by allowing estimates and retirements via mail.
- The Board has made great strides in our efforts to improve our progress toward increasing participation by minority, women and disabled owned firms. Fees paid to minority and women owned firms for investment management increase from 9.33% in FY 12 to 13.18% in FY13, a 41% increase. Through the first quarter of FY14, the percentage increased to 17.65%, a 34% increase over FY13 and an 88% increase over the FY12 figure.
- As part of our efforts to increase our participation goals, the Board again conducted a Utilization Study using Evestment Alliance Database to determine the number of available minority and women owned investment management firms that meet the Board's minimum criteria among the investment universe. The Utilization Study showed that 12.1% of firms qualified as minority or female owned firms pursuant to the definitions in the Mayor's OEO Executive Order.
- The Board also developed criteria which broadened the scope of investment opportunities for emerging, minority or women managers outside the areas of public equities and fixed income to extend to the area of private equity, real estate and hedge funds. The new criteria resulted in the hiring of several diverse managers in the area of alternative investments. The Board anticipates at least \$120 million of allocations to diversity managers in the alternative asset class during the remainder of calendar year 2014. More detail is included in the Investment section of our testimony.
- Efforts to increase participation in the 457 Deferred Compensation program have been successful. Through February 28, 2014, there were 17,496 participants, which is a 4.9% increase from the previous year. Since 2008, the number of 457 Deferred Compensation participants has increased 30% and assets of participants rose 79%.

DEPARTMENT CHALLENGES

- An initial challenge upon was to coordinate the workflow of the department in a manner that enabled the talented and knowledgeable staff to fully use their skills. By creating a largely flat organization and empowering our employees to challenge the conventional or accepted way of doing things, we believe the free flow of ideas among all of us has resulted in finding improvement of processes and professional growth of our professionals.
- The current challenge is to continue to ensure that silos do not exist and that everyone feels empowered to share their ideas and/or question established procedures to improve the workplace.
- A central challenge of the Board and investment staff is to continue to work diligently to identify investments which will reduce fees, provide above-market returns and mitigate risk.

STAFFING LEVELS

- The current budgeted staffing level appears to be at the appropriate level. Our intent is to continue to evaluate and review the vacancy level based on necessity.
- The fiscal year 2015 budget contains funding for 77 positions that service nearly 65,000 participants. This is the same number of positions that are budgeted for in the current fiscal year. To date in FY14, the Board has no expenditures for either overtime or temporary staff. Overtime and temporary staff expenditures during previous years were as follows: FY13 (\$0 / \$3,336); FY12 (\$0 / \$0); FY11 (\$1,580 / \$1,389); FY10 (\$45,051 / \$22,175); FY09 (\$112,963 / \$66,814); and FY08 (\$111,332 / \$89,031).

- The staff of the Board of Pensions is 79% female, 60% African-American and 5% Asian-American. The Board's executive staff is composed of the Executive Director, Deputy Pension Director, the Chief Investment Officer, the Deputy Chief Investment Officer and three Benefit Administrators. The demographic of the executive staff is 57% female and 71% minority.
- There is not a large multilingual population at the Board. One staff member speaks Hindi and another Italian.

PAST INITIATIVES

- Restructuring the workflow at the Board was an initial priority that has been relatively successful and we continue to look for ways to improve.

CURRENT INITIATIVES

- A current initiative that has a cost associated with it is the Board's involvement in the One Philly Modernization Project. The goal of One Philly is to provide a new pension system that will be integrated with the updated systems of Human Resources, Payroll and Benefits to allow us instant access to an employee's work history and payroll data in a manner that will provide comprehensive information immediately instead of relying of third parties to provide the necessary data. Integration of the systems will allow for greater efficiencies and immediate accuracy without resort to a manual review process.
- Increasing our OEO participation level is an initiative that has seen increases in recent years and will continue to be a focus of the Board.

NEW INITIATIVES

- A new initiative that is in the late planning stages involves enhancing the web site to include writeable forms that will allow a member to complete and submit necessary retirement forms online. Although using an automated or self service system will not be required, we believe providing the additional option is likely to have a similar acceptance level of the recently implemented mail option.

OTHER BUDGETARY IMPACTS

FEDERAL AND STATE (WHERE APPLICABLE)

- N/A

OTHER

FUNDING PERCENTAGE

According to the Board's 2013 Actuarial Valuation Report, the funding percentage for the plan year ending on June 30, 2013 is 47.4%, a decrease from the 48.1% funding level for the same period in FY12. According to the actuary, the valuation results reflect the effect of a decrease in the assumed rate of return from 7.95% to 7.85% and the application of a 0.54% liability load to account for funding of benefits payable under the Pension Adjustment Fund (PAF). The actuary states further that "while this ratio may appear to reflect lack of progress in funding, the Fund's risk profile is being improved by including funding for the PAF and lowering the discount rate."

On a market to liability basis, the funding percentage increased from 42.4% to 43.9% for the plan year ending June 30, 2013, reflecting favorable investment return results.

The Board continues to work with the Administration to reduce the assumed rate of return. The Board voted in March 2014 to reduce this rate from 7.95% to 7.85%. Over the last six years, the assumed rate of return has been reduced ninety basis points (8.75% to 7.85%), which is more than three times greater than the combined reductions over the last several decades. As indicated by the actuary, although reducing the assumption rate is a factor that reflects negatively on current the funding ratio, the lower rate improves the Fund's risk profile going forward.

LEGISLATION

We continue to administer the terms of Council legislation concerning DROP and PLOP, subject to applicable stipulations agreed to by the unions and the administration, staying full implementation pending the outcome of current litigation.

Plan 10, the hybrid defined benefit and defined contribution plan, has been implemented for new Police, Fire, Deputy Sheriff's and Register of Wills employees. New employees represented by District Council 47, Correctional Officers, as well as certain employees not covered by collective bargaining agreements are also subject to Plan 10 pending Council's passage of legislation.

RETIREMENTS

From July 1, 2013 through February 28, 2014 there were 1,135 retirements and 577 withdrawals of contributions. The totals for the corresponding period in FY13 were 945 retirements and 504 withdrawals of contributions.

For the period July 1, 2013 through February 28, 2014, there were 27 DROP enrollments. For the corresponding period of July 1, 2012 through February 28, 2013, there were a total of 266 final DROP enrollments.

We noted in last year's testimony that in anticipation of over two hundred DROP retirees scheduled in June 2013, we instituted a pilot program in February 2013 notifying the June group of retirees of the option of completing their retirement via mail. Following an initial letter asking the June retirees whether they were interested in completing their retirement via mail, pension staff sent out the required forms, detailed instructions, and name and contact information of a personal counselor to those who were interested. Approximately 40% of those contacted selected the mail option. As a result of the success of this pilot program the Board now offers the mail option as a normal practice.

CONTRACTS

The centralization of the Board's contracting function continues to alleviate an administrative burden from the Investment Unit staff and free the Board's investment professionals to devote their undivided attention to pursuing successful investment strategies. Centralization has also created a more concentrated effort in the contracting area, and in coordination with the Law Department, ensured Board compliance with all City contracting rules and regulations, and ensured compliance by our vendors with both State and local laws, such as PA Act 44.

OEO GOALS

Fees paid to investment managers make up the largest portion of the Board's contract expenses. These management fees are asset based and can vary greatly depending on the change of asset levels, making fees for the remainder of FY14 and FY15 difficult to project.

Additional outreach to increase the Board's participation percentage includes sending notification of every RFP to the following organizations:

- African American Chamber of Commerce of Pennsylvania, New Jersey and Delaware
- Greater Philadelphia Chamber of Commerce
- National Association of Asian American Professionals
- Greater Philadelphia Urban Affairs Coalition
- Women's Business Development Center

Furthermore, we send notification of all RFP's to OEO.

It is the Board's intent to continue our outreach efforts in order to increase the use of minority, women and local managers, while also prudently exercising our fiduciary duty to the Pension Fund.

RETIREMENT SEMINARS

Retirement Planning Seminars continue to be attended by an average of 60 persons per session. Eight (8) of these programs are held per year.

A secondary retirement education program designed to serve those employees in the early stages of retirement planning, has been in place for five years. The average attendance at these sessions, which are held six times per year, is 60 employees. In addition, the Board's Deferred Compensation Provider has a Certified Financial Planner available for consultation free of charge for all members.

The Board utilizes its own staff and that of the 457 Plan Third Party Administrator to deliver presentations at these seminars. As a result the projected cost for providing these programs in FY14, and all years going forward, is limited to the cost of distributing handouts of the various presentations. This is an annual saving of approximately \$50,000 per year in comparison to the cost of compensating presenters from outside the Board.

Pension staff also participates in education seminars at the Fraternal Order of Police, Firefighters Local 22, District Council's 33 & 47, as well as various City departments for non-represented and exempt employees several times per year.

INVESTMENTS

The Pension Fund returned 12.1% on a market basis for the fiscal year ending June 30, 2013 with a net asset value of \$4.43 billion. The actuarial market basis return was 10.9% reflecting a different calculation method that is more sensitive to the timing of cash flows, with a net asset value of \$4.45 billion. Based on the annual actuarial valuation, the Fund's actuarial return, which is the ten-year smoothed return, as of June 30, 2013 was 5.08% and the funding ratio was 47.4%, a reduction from the funding ratio of 48.1% for June 30, 2012, reflecting mainly the 0.10% decrease in the assumption rate and the 0.54% liability for the Pension Adjustment Fund. Markets continued to perform well in the latter half of 2013 and the Fund was able to generate approximately a 14% return for the Calendar year ended December 31, 2013. Since the end of the 2013 fiscal year, the Fund has returned 10.6% and increased its net asset value to \$4.51 billion as of February 28, 2014.

Working in conjunction with the Plan's General Consultant, the Board conducted a comprehensive review of the Plan's Opportunity Fund, a Manager-of-Manager program designed to provide capital to diverse, local and emerging investment managers that have traditionally faced certain disadvantages when seeking institutional capital. The focus of the review was guided by the following themes:

- Modification of the asset allocation and investment implementation strategy
- A broader use of alternative strategies to reduce portfolio volatility
- A reduction in fees through proactive fee negotiation with new managers, the elimination of hedge fund of funds, increased passive management, and greater internal active management.
- The termination of underperforming active managers to reduce drag on the Plan's overall performance
- Reduction in the overall number of traditional active relationships
- Sizing manager relationships to have the desired impact on Fund performance

After a thorough review of all options available, the Board elected to restructure the Opportunity Fund allocation in a way that would better reflect the current investment landscape, the new asset allocation and strategy implementation. This restructuring was designed to allow the plan to retain the benefits of investing in diverse, local, and early stage managers and other innovative strategies but, at the same time, improve the probability of extracting competitive investment performance from the new allocation. The restructuring moved the Plan away from the Manager-of-Manager model and focused on creating a direct relationship with the underlying investment managers. The results of the restructuring are as follows:

- Direct relationship provides the Board with greater flexibility and control for the review, selection, sizing, monitoring and termination of investment managers. In addition, direct relationships allow greater flexibility to adjust the overall portfolio to meet asset allocation targets and the payment of benefits.
- Removes the additional layer of fees that were charged by the Manager-of-Managers and provides the opportunity to negotiate investment manager fees directly.

- Diverse, local and emerging investment managers want to have a direct relationship with Institutional Investors. This relationship is symbiotic as the City benefits from greater control of its investments and the manager benefits in the marketplace by having a direct institutional relationship which is often required prior to receiving more capital from other institutional investors.
- Focuses the Opportunity Fund mission to invest in diversity, local, and emerging managers across all asset classes, including Alternative Investments in hedge funds, private equity and private real estate. This will increase the number of funds available beyond the current universe and offer the Plan more options for the strategic deployment of capital.
- The overall sizing of the Opportunity Fund will increase as all asset classes and strategies are included.

Since the restructuring, the following allocations have been made to diversity and local investment managers

- \$20 million commitment to an African American owned private equity fund – August 2013
- An additional \$10 million commitment to an existing local private real estate fund – September 2013
- \$27 million to a Woman owned International Equity focused manager – December 2013
- \$30 million to an Asian American owned hedge fund – February 2014.

In addition, for the calendar year 2014, the Board is anticipating at least \$120 million of allocations to diversity managers specifically in alternative asset classes. It is also expected that these additional allocations will increase the diversity participation in the Plan while providing superior risk adjusted returns to the beneficiaries.

It is the goal of Board of Pensions staff to continue to provide education and improved services to its members and I respectfully request your approval of this proposed budget.

CONTRACTING EXPERIENCE

M/W/DBE Participation on Large Contracts

FY14 Contracts

Vendor	Service Provided	Amount of Contract	RFP Issue Date	Contract Start Date	Ranges in RFP	% of M/W/DBE Participation Achieved	\$ Value of M/W/DBE Participation	Total % and \$ Value Participation - All DSBEs	Living Wage Compliant?
Beachpoint	Investment Manager	\$600,564			MBE: WBE: DSBE:				
Mason	Hedge Fund	\$365,215			MBE: WBE: DSBE:				
Taconic	Hedge Fund	\$353,023			MBE: WBE: DSBE:				
PPM	Manager of Managers	\$295,225	7/9/08	11/1/08	MBE: WBE: DSBE:	78% 13%	230,098 37,316	91% \$267,415	Y Y
Baring	International Equity	\$287,017	6/29/10	6/1/11	MBE: WBE: DSBE:				

DEPARTMENT EMPLOYEE DATA

Staff Demographics

Full-Time Staff

Executive Staff

	Male	Female	Male	Female
Total	13	48	3	4
% of Total	21%	79%	43%	57%
African-American			African-American	African-American
Total	2	35	0	4
% of Total	3%	57%	0%	57%
White			White	White
Total	8	13	2	0
% of Total	13%	21%	29%	0%
Hispanic			Hispanic	Hispanic
Total	0	0	0	0
% of Total	0%	0%	0%	0%
Asian			Asian	Asian
Total	3	0	1	0
% of Total	5%	0%	14%	0%
Other			Other	Other
Total	0	0	0	0
% of Total	0%	0%	0%	0%
Bi-lingual			Bi-lingual	Bi-lingual
Total	2	0	2	0
% of Total	3%	0%	29%	0%

