

**BOARD OF PENSIONS AND RETIREMENT
FISCAL YEAR 2016 BUDGET TESTIMONY
APRIL 8, 2015**

EXECUTIVE SUMMARY

DEPARTMENT MISSION AND FUNCTION

Mission: The Board of Pensions and Retirement (the Board) is responsible for the creation and maintenance of an actuarially sound Retirement System for the benefit of all current and future benefit recipients. The nine member Board is composed of the Director of Finance, who serves as chairperson, the Managing Director, the City Solicitor, the Human Resources Director, the City Controller and four members who are elected by the Civil Service employees of the City. In addition, there is one non-voting member on the Pension Board, who is appointed by the President of City Council. The Executive Director administers the day-to-day activities of the Retirement System, providing services to over 64,000 members.

Description of Major Services: The Board acts as a ‘trustee’ to make sure that the Retirement System remains actuarially and financially sound for the benefit of current and future benefit recipients. With the assistance of staff and professional consultants, the Board manages assets in the pension system and develops policies and strategies that enable the Board to successfully implement its fiduciary duties. In addition, the Board formally approves all benefit applications.

PROPOSED BUDGET HIGHLIGHTS/FUNDING REQUEST

Budget Highlights: The Pension Board is entirely funded by the Pension Fund. The Pension Board’s proposed FY16 budget is \$2.4 million lower than the current projection for FY15 because FY15 included one-time costs related to the One Philly Project.

Fund	Class	FY14 Actual	FY15 Current Projection	FY16 Proposed Budget	FY16-FY15 Change	FY16-FY15 Percent Change
Other*	100	6,448,745	7,058,000	7,170,000	112,000	1.6%
	200	1,753,784	5,093,667	2,538,000	(2,555,667)	-50.2%
	300/400	65,771	138,000	138,000	0	0.0%
	800	178,885	125,000	125,000	0	0.0%
	Total	8,447,185	12,414,667	9,971,000	(2,443,667)	-19.7%
	Positions	50	77	73	0	0.0%

Staff Demographics Summary (as of December 2014)

	Total	Minority	White	Female
Full-Time Staff	58	36	22	44
Executive Staff	7	5	2	4
Average Salary - Executive Staff	\$107,537	\$95,492	\$137,649	\$79,583
Median Salary - Executive Staff	\$98,325	\$98,325	\$159,131	\$77,634

Employment Levels (as of December 2014)

	Budgeted	Filled
Full-Time Positions	77	58
Part-Time Positions	0	0
Executive Positions	7	7

Contracts Summary (* as of December 2014)

	FY10	FY11	FY12	FY13	FY14	FY15*
Total amount of contracts	\$31,026,354	\$32,546,075	\$27,410,231	\$29,890,980	\$37,621,563	\$8,263,554
Total amount to M/W/DBE	\$3,372,233	\$4,216,549	\$2,560,146	\$3,939,110	\$4,881,899	\$1,196,500
Participation Rate	11%	13%	9%	13%	13%	14%

PERFORMANCE, CHALLENGES AND INITIATIVES

DEPARTMENT PERFORMANCE (OPERATIONS)

The Pension Board staff is efficient and professional. One of the measures we use is the administrative cost per member to perform our duties. The most recent data available shows that through June 30, 2014, our cost to administer the plan is \$130 per member. Although the previous annual cost figures decreased from prior years, the \$130 cost is the lowest for a full fiscal year since adopting the measurement. According to the Pennsylvania Employee Retirement Commission, our annual cost per employee is among the lowest in the industry.

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.

DEPARTMENT CHALLENGES

Ongoing management challenges include harnessing 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.

An initial challenge 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 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.

ACCOMPLISHMENTS & INITIATIVES

Improved Returns and Updated Investment Strategy: Following the financial distress and contraction of the world stock markets in 2007-2009, the Fund reviewed its asset allocation and adopted an asset mix intended to create more income and reduce relative risk; while positioning itself to capture positive market performance. The annual market returns and corresponding actuarial returns are listed in the following table. The actuarial return smoothes gains and losses over a number of years to lessen their impact on any one year.

Fiscal Year	Market Return	Actuarial Return
FY10	13.8%	12.9%
FY11	19.4%	9.9%
FY12	0.2%	2.4%
FY13	12.1%	5.1%
FY14	15.7%	4.8%

Increased Number of Electronic Fund Transfers: The Board continues to increase the percentage of monthly benefit recipients who receive their payment through electronic funds transfer (EFT). That number now stands at 31,764, representing over 91% of the Board's monthly payments. Each monthly EFT recipient saves the Board \$4 in postage annually.

Improved Online Access to Information: The Board continues to update its website to include more forms that are commonly used by members and provide access to retirement benefit and investment information for those who are

interested in learning more about the Pension Fund. Minutes of the Board's monthly benefit, investment and deferred compensation meetings are posted to this site as soon as they are approved by the Board.

Increased Number of Deferred Compensation Participants: The Board continued to increase the number of deferred compensation participants by holding deferred compensation seminars at department locations, distributing educational materials, implementing online enrollment and contribution authorization, and by generally increasing employee awareness of the benefits of the program. Membership in deferred compensation through February 28, 2015 was 18,544 (up from 17,496 on February 28, 2014) with total assets of \$896 million (up from \$824 million on February 28, 2014).

STAFFING

The current budgeted staffing level appears to be at or close to 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 FY15, the Board has no expenditures for temporary staff. The Board anticipates overtime expenditures of approximately \$20,000 in FY15 to address a significant increase in retirements from DROP during the period November 2014 through February 2015. Current DROP participation levels do not forecast a repeat of this peak activity level through FY20, minimizing the Board’s need to utilize overtime going forward.

Overtime and temporary staff expenditures during previous years were as follows: FY14 (\$0 / \$0); 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 76% female, 57% African-American and 5% Asian-American. The Board’s executive staff is composed of the Executive Director, Deputy Pension Director, the Chief Investment Officer and two Benefit Administrators. The demographic of the executive staff is 60% female and 60% minority. There is not a large multilingual population at the Board. One staff member speaks Italian.

Staff Demographics (as of December 2014)

<i>Full-Time Staff</i>				<i>Executive Staff</i>			
		Male	Female			Male	Female
		African-American	African-American			African-American	African-American
<i>Total</i>		4	29	<i>Total</i>		0	4
<i>% of Total</i>		6.9%	50.0%	<i>% of Total</i>		0.0%	57.1%
		White	White			White	White
<i>Total</i>		7	15	<i>Total</i>		2	0
<i>% of Total</i>		12.1%	25.9%	<i>% of Total</i>		28.6%	0.0%
		Hispanic	Hispanic			Hispanic	Hispanic
<i>Total</i>		0	0	<i>Total</i>		0	0
<i>% of Total</i>		0.0%	0.0%	<i>% of Total</i>		0.0%	0.0%
		Asian	Asian			Asian	Asian
<i>Total</i>		3	0	<i>Total</i>		1	0
<i>% of Total</i>		5.2%	0.0%	<i>% of Total</i>		14.3%	0.0%
		Other	Other			Other	Other
<i>Total</i>		0	0	<i>Total</i>		0	0
<i>% of Total</i>		0.0%	0.0%	<i>% of Total</i>		0.0%	0.0%
		Bi-lingual	Bi-lingual			Bi-lingual	Bi-lingual
<i>Total</i>		0	0	<i>Total</i>		0	0
<i>% of Total</i>		0.0%	0.0%	<i>% of Total</i>		0.0%	0.0%
		Male	Female			Male	Female
<i>Total</i>		14	44	<i>Total</i>		3	4
<i>% of Total</i>		24.1%	75.9%	<i>% of Total</i>		42.9%	57.1%

CONTRACTING

**M/W/DBE Participation on Large Contracts
FY15 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?
400 Capital	Hedge Fund Manager	\$924,392	N/A	6/1/13	MBE: N/A	0%	\$0		N/A
					WBE: N/A	0%	\$0	0%	
					DSBE: N/A	0%	\$0	\$0	
Axonic	Hedge Fund Manager	\$623,552	N/A	2/1/13	MBE: N/A	0%	\$0		N/A
					WBE: N/A	0%	\$0	0%	
					DSBE: N/A	0%	\$0	\$0	
KKR	Hedge Fund Manager	\$390,312	N/A	7/1/13	MBE: N/A	0%	\$0		N/A
					WBE: N/A	0%	\$0	0%	
					DSBE: N/A	0%	\$0	\$0	
ICMA-RC	457 Plan TPA	\$266,460	N/A	9/1/12	MBE: N/A	0%	\$0		Yes
					WBE: N/A	0%	\$0	0%	
					DSBE: N/A	0%	\$0	\$0	
PFM	Oppty Fund Mgr of Mgrs	\$262,751	N/A	11/1/08	MBE: N/A	87%	\$227,736		Yes
					WBE: N/A	13%	\$35,015	100%	
					DSBE: N/A	0%	\$0	\$262,751	

As part of the Board’s efforts to increase participation goals, the Board again conducted a Utilization Study using PSN to determine the number of available minority and women owned investment management firms that meet the Board’s minimum criteria among the investment universe. Using the PSN Database, Staff created a filter to get a universe of managers that have a 3 year track record and an active product with at least \$100 million in Assets Under Management. After running the filter, 1,170 firms with 8,159 products were available. Of this amount, 110 firms and 494 products had greater than 50% minority or woman ownership. This equates to 9.4% of firms and 6.1% of products. As of 2/28/2015, the Board had a total 108 managers, of which 26 were MWBE products, a percentage of 24.1%.

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 continued allocations to diversity managers in the alternative asset class during the remainder of calendar year 2015. More detail is included in the Investment section of our testimony.

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 FY15 and FY16 difficult to project.

Recently, the Board agreed to support the Thirty Percent Coalition. This Coalition is a group of industry leaders, including institutional investors, who collaborate to achieve gender diversity in public company boardrooms. In addition, we work closely with our proxy consultant and join with other public pension funds to leverage our shareholder influence in order to increase ethnic and gender diversity and reform general corporate governance.

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.

OTHER BUDGETARY IMPACTS

FEDERAL AND STATE (WHERE APPLICABLE)

N/A

OTHER

Funding Percentage:

According to the Board's 2014 Actuarial Valuation Report, the funding percentage for the plan year ending on June 30, 2014 is 45.8%, a decrease from the 47.4% funding level for the same period in FY13. According to the actuary, the valuation results reflect the effect of a decrease in the assumed rate of return from 7.85% to 7.80% 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 43.9% to 46.1% for the plan year ending June 30, 2014, 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 7.85% to 7.80%. Over the last seven years, the assumed rate of return has been reduced ninety five basis points (8.75% to 7.80%), which is more than three times greater than the combined reductions in the entire history of the fund. As indicated by the actuary, although reducing the assumption rate is a factor that reflects negatively on the current funding ratio, the lower rate improves the Fund's risk profile going forward. Through February 2015, the average annual return of the Fund since inception is 7.80%.

Legislation:

The Board continues 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, Exempt, Non-Represented, District Council 33 and 47 represented, Deputy Sheriff's, Correctional Officers, and Register of Wills employees. The Correctional Officers and Register of Will employees are mandatory Plan 10 participants; while all other employees have the option to opt out of Plan 10 and pay an additional 1% pension contribution rate.

Retirements:

From July 1, 2014 through February 28, 2015 there were 823 retirements and 455 withdrawals of contributions. The totals for the corresponding period in FY14 were 820 retirements and 577 withdrawals of contributions.

For the period July 1, 2014 through February 28, 2015, there were 352 DROP enrollments. For the corresponding period of July 1, 2013 through February 28, 2014, there were a total of 274 DROP enrollments.

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 FY15, 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 15.6% on a market basis for the fiscal year ending June 30, 2014 with a net asset value of \$4.91 billion. The actuarial market basis return was 15.7% reflecting the differences created by the actuary using a different return calculation method that is more sensitive to the timing of cash flows, with a net asset actuarial value of \$4.81 billion. Based on the annual actuarial valuation, the Fund's actuarial return, which is the ten-year smoothed return, as of June 30, 2014 was 4.81% and the funding ratio was 45.8%, a reduction from the funding ratio of 47.4% for June 30, 2013, reflecting mainly the 0.05% decrease in the assumption rate and the 0.54% liability for the Pension Adjustment Fund.

In 2014 the Plan was named *Institutional Investor's* Small Public Plan of the Year, a category that includes public plans that are \$15 billion and under in assets managed. Institutional Investor, a monthly periodical that is published by Euromoney Institutional Investor, held their 12th annual Industry Awards event in New York City in June of 2014. The awards recognize U.S. institutional investors whose innovative strategies and fiduciary knowledge stood out in the eyes of the investor community for their extraordinary performance, risk management and service.

Working in conjunction with the Plan's General Consultant and investment staff, the Board approved an asset allocation strategy in January of 2015 that reaffirmed last year's target portfolio mix. The allocation study continues to focus on the optimal allocation mix of investment strategies that will achieve the targeted actuarial level of return at the lowest possible level of risk to the Plan. The asset mix builds on the prior allocation recommendation to target strategies that are designed to generate current income while also dampening the overall level of return volatility.

The Board, with assistance from the Plan's General Consultant and investment staff, 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. 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 and the new asset allocation and strategy implementation. 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 benefits of this 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, including (but not limited to) 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 has, and will continue to, increase as all asset classes and strategies are included.

The Plan initiated a comprehensive search across all asset classes to seek out the best available diverse, local and emerging investment managers. Existing Plan managers were evaluated alongside external managers and a final line-up of high quality domestic equity, fixed income, and international managers were selected for a direct allocation of capital. The allocations made to diversity and local investment managers total \$499 million.

As part of this transition away from the manager-of-manager model to a direct fund investment in diverse, local and emerging managers in the domestic equity, international equity and fixed income asset classes, the Board was able to negotiate a reduction in overall fees of approximately \$900,000 per year going forward.

The Board continues to seek out high quality diverse, local, and emerging managers for allocations across all asset classes, including alternative investments. 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.