

A special called meeting of the **Pension and OPEB Committee** was held February 27, 2014 at 9:00 a.m. in the Administration Conference Room at Town Hall, 500 Poplar View Parkway.

The following members were present: Dick Gardiner, Stan Joyner, Jane Bevill and Jay Jeffries.

Staff present was James Lewellen and Lynn Carmack. Also present was Pension Attorney Frank Carney.

**TOWN OF COLLIERVILLE, TENNESSEE, PENSION AND OPEB PLAN ANALYSIS – PFM ADVISORS (Frank Carney, Pension Attorney)**

Mr. Carney explained that the Pension Committee had engaged PFM Advisors to review the performance of First Tennessee with respect to investments of the Town Pension Plan and the OPEB Plan. He stated it is the Pension Committee's obligation, from a fiduciary standpoint, to examine the report and make a decision on whether any actions should be taken with regard to the current investment philosophy.

With regard to the report, Mr. Carney noted that it is clear that PFM and First Tennessee have different financial philosophies. However, PFM concluded at the end of the report that *"Based on the performance shown in the December 31, 2012 Performance Report provided by First Tennessee, the overall relative performance of the Plans appears to be very good"*.

Concerning asset allocation, PFM did not object to the manner in which the assets are allocated, but did recommend higher risk investments that would yield higher returns to hit the Town's 7.5% goal. Mr. Carney noted that the Pension Committee has always rejected those kinds of investments. He stated it would be appropriate, if the Pension Committee wanted, to have First Tennessee review the asset allocation report and provide a response.

Mayor Joyner asked if First Tennessee had seen the report. Mr. Carney responded that they had not.

Mr. Carney said the biggest thing PFM objects to in the report, is First Tennessee's investment in individual securities. First Tennessee was questioned by the Committee about this topic at the last Pension Committee. Mr. Carney believed First Tennessee was beginning to realign some of those investments, but noted the Committee can always raise the issue with them again.

PFM noted that the individual securities is over the limit in the Investment Policy, as individual securities are not supposed to be more than 10% of the total fund, and they are currently 25% per PFM's calculations. Mr. Carney stated their calculation method may be different than First Tennessee's, so it would be worthwhile to have Mr. Ferguson respond to some of these comments.

Mayor Joyner said he would like to have a response from First Tennessee and have it become part of the record. Each of the other members agreed.

Mr. Gardiner asked if all of the owned assets are in trust.

Mr. Carney confirmed that they are owned in trust, and noted that this was the topic of another PFM comment in the report. The report notes that First Tennessee serves as both custodian of the funds and investment advisory services. While it is common for plans to have a bank that is both custodial and investment advisor, PFM noted it could result in conflicts of interest. However, PFM did acknowledge that in that arrangement, fees are very low because you are not paying a separate custodial fee and an advisory fee.

Mr. Carney cautioned the Committee to be aware of what information PFM considered when drafting their report. For example, PFM noted the current asset mix does not meet the targets identified in the Investment Policy; however, they did not read Pension Committee minutes to know the Committee previously revised those targets in a meeting. In addition, one recommendation on page 28 is, "*Consider the creation of an individually designed Investment Policy Statement to include the duties, responsibilities, policies and procedures of the Pension Committee.*" The Investment Policy Statement does not go into the duties or describe how the Pension Committee is formed; that information is in the Plan Document. PFM noted this as a deficiency because they had not reviewed the Plan. PFM revised their report when it was pointed out, and recommends referencing any additional charters, resolutions or ordinances in the Investment Policy Statement, thereby incorporating them by reference.

Mr. Carney's next point from the report was in regard to the OPEB Trust. He explained that the State allows you to invest in accordance with how domestic life insurance companies invest or in accordance with your Pension Policy. Collierville incorporated the Pension Policy as the Investment Policy Statement for the OPEB. The PFM report says, "*Consider implementing a separate Investment Policy Statement for the OPEB Trust.*"

Mr. Carney explained why he is hesitant to have a fully separate policy, as the Tennessee OPEB Act says you invest in accordance with your Pension Policy. The Pension Policy is in the OPEB book now, with the resolution on top of it saying this is the OPEB Policy. The resolution meets the statute.

PFM also noted that the OPEB Plan is invested slightly differently than the Pension Plan, although it is within ranges and consistent with the policy. The Pension Committee is aware of this, and it is purposeful as the Committee decided to take a more long term look at OPEB assets than Pension assets.

Next, the report states, "*Consider having legal counsel review the Investment Policy Statement and any subsequent changes going forward*". Mr. Carney stated that he has reviewed the Investment Policy Statement as an attorney, not as a financial advisor. The Committee could chose to add a statement saying it has legally been reviewed to form, if desired.

PFM has a different philosophy on asset allocation and would have many more index funds than First Tennessee. Mr. Carney noted that their comment is that they fear active management has a cost that is not offset by its benefits. PFM would clearly recommend more index funds and not have individual stocks, which is a decision for the Pension Committee.

Mr. Gardiner asked if there were limitations on the amount of stocks, bonds, and fixed income.

Mr. Carney responded that the Investment Policy Statement states 60 percent equity and 40 percent fixed income. There are classifications like domestic equity, international equity and fixed income, and each of those have a range. Those ranges and brackets are amended by Committee minutes. First Tennessee reports to the Committee on whether they are outside those ranges, and if they are, the Committee must decide if that is acceptable. If they get materially outside that range, then the Committee must decide if they want to bring it back or amend the range or change the targets. The Committee does that; that is what they should do; it is appropriate.

Mr. Carney repeated that the only area PFM noted in their report that was over the target and the range was individual securities. That comment is found in the report under investments, stating "*Address the violation of the maximum 10% invested in individual securities policy in the Defined Benefits Pension Plan*". The Committee can ask First Tennessee to explain this and then decide whether to have them to bring it back to 10% or change the policy. PFM recommends liquidating all individual securities. Mr. Ferguson spoke about beginning to liquidate those at the last Pension Committee meeting. PFM also discussed a greater use of index funds.

On page 29 of the recommendations of PFM, under the Plan Performance and Reporting, PFM states they do not feel the reports provided by First Tennessee were adequate. Mr. Carney stated that he has not seen a deficiency there, and did not see where PFM detailed specific inadequacies.

Mr. Jeffries agreed that he did not note a deficiency and felt it was more difference in reporting style.

Next, Mr. Carney said that PFM noted that "*First Tennessee costs are low.*" They took Mr. Ellis' costs and added them to First Tennessee's costs and said that in the aggregate, that is low. Other than PFM's dislike of the individual investments and the fact that First Tennessee can make additional money out of how they choose that, they did not have anything really negative to say about the Plan costs.

PFM could not tell from the Investment Policy whether the 7.5% investment objective was net or gross of fees. They noted that it looks to be net, because later on the policy talks about an overall 8.15% expected return. This can be confirmed by First Tennessee. PFM's report recommended considering if that is an achievable number, and Mr. Carney said that we have done that in the past. Previously, Mr. Ellis did not think that was necessary and the Committee accepted that. While PFM did not suggest changing it, they did suggest periodically looking at it, which Mr. Carney said makes sense, particularly when Mr. Ellis gives his actuarial report.

Mr. Gardiner asked if 7.5% is common among a lot of municipal plans in Shelby County.

Mr. Carney said yes and that it is actually common across the country. He mentioned that there is new legislation from the state on pension funding addressing what sort of range you can have

on these numbers. In summary, the Board has reviewed the objectives in the past with First Tennessee, and the objectives will continue to be periodically reviewed with the Board. The state may enter that forum also and will likely say you cannot have 8%.

Mayor Joyner commented that the Town received a letter from Treasurer Lillard within the last week or so regarding the state of our Plan and the assumptions in it, and that he was very complimentary on the Plan and on the funding level.

Mr. Carney agreed that the Treasurer does not have a problem with this plan, having noted its ARC is funded well within the range.

Mr. Gardiner asked what percentage the actuary says the plan is funded.

Ms. Bevill replied it is between 123% to 125%. She said there are two percentages that were put in the CAFR, and the two different percentages are about 74% and 120%. The one the Treasurer looked at is the 123%.

Mr. Carney answered that the percentage of the ARC in 2012 was 125.2%, as it was overfunded. But in terms of the total Plan Market Value, it was 77.6% in 2012, and is probably higher than that now.

Mr. Lewellen asked for a description of market value percentage.

Mr. Carney explained that they take the liabilities based on all participants' future salaries and future service to their assumed retirement age. Say you are going to have "X" liabilities and today you have "Y" assets. If you terminated the Plan today and had to fund all of those liabilities now, you could be short. Based on the Treasurer's report for 2012, Collierville would be at 77%; it would be short. It should be noted most plans would be short since future benefits are paid for by annual future contributions. A more realistic measure of a plan's funding level is the value of assets compared to the plan's Actuarial Accrued Liability. Using this measure, the Town's funding percentage is 83%. Mr. Carney stated this plan is not an ERISA plan, but in the ERISA area generally ERISA plans with a funding percentage under 60% are considered to have a serious funding level; if the plan is 60% to 80% funding it is not as serious; and 80% and above is generally deemed on the correct path of funding.

He further explained that the Treasurer, in his legislation, is not so much focused on the funded status of the market value, but on the ARC, because if you fund your ARC at 100% every year, you are going to catch up over your time. But if you fund your ARC at less than 100% now you could fall further behind.

Mr. Carney then said the legislation makes you use a closed 30 year. Reading from the Treasurer's report, Mr. Carney noted the treasurer listed Collierville as using an open 30 year, which means every year you are looking out 30 years. He stated that Richard Ellis' reports show Collierville using a closed 30 years, but if Collierville were using an open 30 year the change could increase the ARC some. Mr. Carney mentioned he had had a conversation with Mr. Ellis and Mr. Ellis, in that conversation, was not worried about changes that might result

from the legislation but he did note there are all sorts of hidden things in the legislation that will result in some changes.

Ms. Bevill stated that Mr. Ellis felt the new GASB rules which go into effect this year really focused on the long 30 year rather than the ARC, and in fact, they do away with the ARC.

Mr. Carney stated the new GASB rules would actually help rather than hurt Collierville. He did not know how the new legislation and GASB would hook together, but said it permits up to a 10 year smoothing. So the Treasurer would allow a longer smoothing period, but whether you want to use that or not, he did not know.

Mr. Jeffries pointed out that part of the liability calculations had assumptions that are not always 100% true, such as anyone participating in the Plan will collect the full amount or consideration that you have participants who will not make it at all.

Mayor Joyner said that it seemed to him that if you used a closed end (30, 29, as described), that you would get yourself in trouble if it was not sensitive to what is happening right now; potentially thinking the Plan was funded when in actuality it was not.

Mr. Carney said he thought the Treasurer was arguing just the opposite, that when you use the open end you fool yourself by saying I am funded when actually you are moving the target away from yourself each year. He said conservative actuaries do not like open ended because you are supposed to fund to a goal, and to keep moving your goal post away does not make sense to them. Mr. Carney suggested asking Mr. Ellis how that 30 works in terms of what presumptions he puts in his calculations, as he didn't know.

Mr. Carney said that the Treasurer identified that about 50% of government units with their own plans are using open, and about 50% are using closed. As a result, a lot of open plans will go to closed, which will have some impact on the ARC. He said because you are funded 125% of your ARC, the changes proposed by the legislation likely would not be a serious impact, but that Mr. Ellis would confirm it.

Mayor Joyner said that if the ARC keeps increasing, then we may eventually be forced to financially rethink a defined benefit plan. Mr. Carney agreed, and said the Treasurer's theory on this is that if you fund your ARC 100%, you will meet your funding.

Mr. Carney then explained a Supreme Court ruling in the 80's that specifically focused on public plans, specifically on the Shelby County Plan. Shelby County tried to change their plan from a 3-year final average to a 5-year final average and was told by the Supreme Court that you cannot change the plan for anybody who is vested or been there 10 years, even though they have not retired or attained retirement age. As such, it makes it very difficult to change the ARC. You can change it for anybody who is not vested, but for those people who are vested, you have to fund for the rest of their lives as they accrue additional years of service, based on the funding that you have already put in place when they were hired. For any employee hired after the effective date of this legislation, you can change anything at any time.

The Committee then discussed other surrounding municipalities and their funding approaches, including Shelby County funding 100% of its ARC and the city of Memphis funding 22% of its ARC, which is what caused all of this and upset the Treasurer. Mr. Carney noted the fact that they have funded 22% of the ARC will have a material impact on 2013, 2014, and 2015. Then it was mentioned that Dyersburg was 72.2% funded in 2012, but they funded 0% in 2012.

Ms. Bevill noted that it will be interesting to see what the state requires Collierville to report; that it will likely be state reporting and GASB reporting in the CAFR.

Mr. Carney responded that you have to adopt a funding policy, which is similar to an investment policy, and that policy has to be approved by the state. He noted that the funding policy could be something as simple as we are going to fund 100% of our ARC and the state would be fine with that.

Mayor Joyner then began a discussion about finding financial advisors to give a truly unbiased evaluation to the Town and how PFM was hired for this review. It was discussed that PFM is the Town's financial advisor who is primarily used for bond issues only, and was more recently selected through an RFP process to evaluate First Tennessee's performance. He noted that if he wanted financial advice, he would want it from someone that he was paying a fee to, rather than a commissioned price. Ms. Bevill clarified that this was totally separate from bond issue, where PFM markets the Town's bond issuance.

Mr. Carney suggested getting an unbiased report from an auditor.

Mr. Jeffries stated that at ARS, they had a financial firm who did not do any investment, but rather provided analysis of investments. They were paid a flat fee and acted as an intermediary group to make sure the investment folks did what they were supposed to do, when they were supposed to do it, and that the fees were reasonable. It was unbiased guidance. The decision was made ultimately by a committee and then it was passed along to the company that did the investments.

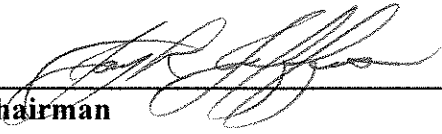
Mayor Joyner and Mr. Lewellen agreed that is what was needed, a clinical analysis without personal bias or opinions included.

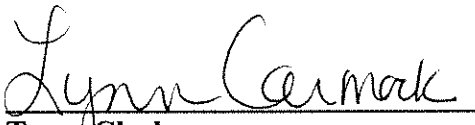
Mayor Joyner stated that the Pension Committee felt that in order to do due diligence, it would go out and do this analysis every so often. He recommended that if the Committee does it again in 5 more years, or whatever the Committee decides, that a clinical, unbiased analysis is the kind of report he would like to see.

Mr. Lewellen concluded by recommending that the Committee give this analysis to First Tennessee and let them respond to it. If their response adds to the confusion, then he suggested finding somebody that is completely unbiased and asking them for a different level of clinical analysis. He felt the Committee will know everything they need after having First Tennessee respond.

Mr. Carney agreed.

There being no further business, the meeting was declared adjourned at 10:00 a.m.

  
Chairman

  
Town Clerk