CLAYTON COUNTY PENSION

Regular Pension Board Meeting | November 10, 2022
8:30 a.m.

MINUTES

PRESENT: Terry Hicks, Chairman; Jim Crissey, Vice-Chair; Stacey Merritt, Interim Secretary; Pamela Ambles Member; and Katherine Dodson, Member.

ALSO PRESENT: Jon Breth, AndCo Consulting; Kevin Spanier and Audrey Cervas, Buck Consultants; Rick Arenburg and Cass Hollis, Bryan Cave Leighton Paisner LLP; Kerri Hathaway, Pension Manager.

1. Chairman Terry Hicks called the regularly scheduled Pension Board Meeting to order.

2. A motion to adopt the agenda was made by Mr. Jim Crissey and seconded by Ms. Katherine Dodson. The vote was unanimous.

3. A motion was made by Mr. Jim Crissey to approve and accept the August 11, 2022, Regular Pension Board Meeting minutes as presented, and his motion was seconded by Stacey Merritt. The vote was unanimous.

4. Mr. Spanier began by stating he would be discussing the July 1, 2022, actuarial valuation results using his presentation titled: “Clayton County, Georgia Employee Retirement System, Presentation to the Pension Board” July 1, 2022, Actuarial Valuation Results. This valuation is a snapshot measurement of the actuarial position of the pension plan. It measures liabilities and compares it to the actual assets of the fund to determine the amount of contributions both the County and Water Authority need to contribute over time to pay for retirement benefits once they are due. This actuarial measurement also ensures the compliance with Georgia Minimum Funding Standards. Over the life of the plan, the contributions made by the employees and employer, plus investment return, equals the benefits and expenses of the plan. Census data is collected on all the members as of June 30, 2022, assumptions/methods are applied along with the plan’s assets, then the plan provisions are applied to determine what type of benefits the members will receive in the future and how those benefits will change over time.

   Mr. Spanier proceeded to the highlights of the valuation: the plan had a negative (18.25%) return on Market Value assets from the prior valuation to present. The plan had a 6.3% return on Actuarial Value assets which increased unfunded liability by $7.7 million. The demographic experience increased the unfunded liability by $9.8 million, which a large portion is due to salary increases over the past year. Lastly, there will be potential assumption changes to reflect a new mortality improvement scale and the salary scale assumption for this year and next year for the Water Authority. With the change, unfunded liability will increase by $10.5 million. The funded ratio decreased from 64.0% to 62.4% based on the actuarial value of assets. The total employer contribution which must be paid by the County and the Water Authority increased from 17.21% to 18.03% of payroll.

At the invitation of Mr. Spanier, Ms. Audrey Cervas led the discussion of Membership profile. Ms. Cervas stated the Membership profile has remained steady with a 7% decrease in active membership and a 16.6% increase in retiree benefits over the past 5 years. The average active pay increased 11.75% from 2021 to 2022. Also in 2022, the average monthly benefit of a retiree in pay status is $2,600 per month and is expected to increase.

Ms. Cervas went on to discuss Plan Assets. The plan continues to be in a negative cash flow position. The year 2021 had a 32% return, but the 2022 produced a negative 18.3% return. The employer contributions decreased, but the benefit payments increased, and the expenses remained the same. There was a negative investment return of $103.3 million, which is recognized over 5 years. Asset gains and losses are recognized over a 5-year period so, it will balance out over time. The assumed rate of return was 8% until the July 1, 2020 valuation, when it was decreased to 7.75%. Historically market value has lagged the actuarial value, with the prior year being an exception.

Mr. Spanier continued with the presentation discussing Proposed Assumption Updates, beginning with the mortality improvement scale. We have two pieces of mortality assumption: base mortality (what does mortality look like today) and projection scale (how will mortality improve over time). National studies are reviewed to assist with these assumptions and these studies produce a mortality improvement scale which is updated yearly. This scale is called MP-2021 and is the last scale prior to COVID. The study that does include the impacts of COVID was released last week. We will review it and make recommendations for next year's valuation. Based on preliminary updated data, it suggests projected life expectancies will increase slightly compared to MP-2020, which results in a higher pension liability for the plan.

Mr. Spanier stated salary scales were updated as part of the experience study to reflect the County's and Water Authority's expectations of future salary growth. Valuation data indicated that current year budget provides for a larger than average increase. When someone receives a salary increase, they also receive a pension increase.

Mr. Spanier continued on to review Present Value of Plan Benefits. Retirement benefits are earned for the future, and benefits are being paid as they are being earned. It is anticipated members will pay $78.4 million dollars of future benefits and the County and Water Authority will pay $60.7 million dollars of future benefits and the remainder has already been earned. We have $517.3 million Actuarial value assets and $311.0 million in unfunded liability.

Next, Mr. Spanier explained the Actuarially determined contribution. For 2022, members contribution rate is 7.5% toward benefits being earned. Based on Georgia Minimum Funding standards, 13.7% of payroll is the amortized percentage to pay off the debt. This percentage was slightly above last year, but lower than 14.4% in 2020. The increase from 2019 to 2020, was a result of assumption changes in a 2020 experience study. The difference of 4.4% is being paid by the County and Water Authority.

The funded ratio has changed over the time span from 2001 to 2022. Mr. Spanier discussed the decrease in 2022 is mainly due to poor asset performance and larger than expected salary increases. This will continue to be discussed in future meetings.

Next item of discussion are the potential risks to the funds financial condition and a few areas where deviations may occur: Investment risk, Contribution risk, Payroll growth risk and Demographic risk. Investment risk: we are assuming 7.75% investment rate, long term over the life of the fund. If the actual return is higher than 7.75%, we risk paying too much and if the actual return is lower, we risk not paying enough. Contribution risk: risks that contributions will not cover benefits over the lifetime of the fund. Payroll Growth Risk: payroll will grow at a rate different than expected. Lastly, Demographic risk: We are making assumptions of how long people are going to live, when they will retire, and how long they are going to continue working. If those assumptions do not hit the mark, it will impact the fund.

Jon Breth pointed out, investment risk has been about compression in return expectations. A lot has been based on low interest rates, but as interest rates have increased, that has created an opportunity to earn money on fixed income again and has increased expectations on equity.

Mr. Spanier then stated it is standard practice to review your expected return yearly to make sure it is in line with a reasonable range.

Mr. Spanier moved on to ASOP #4 (Actuarial Standard of Practice) discussion as a reminder the #4 revision will be required on the actuarial valuation next year (effective for the 7-1-2023 valuation report). This #4 revision will require a disclosure of a new liability measured called a "low-default-risk obligation measure" (LDROM). Also, we will review the employer contributions to ensure they are reasonable enough to pay off the unfunded liability. If not, we will recalculate and disclose the needed amount.

In closing, Mr. Spanier discussed next steps: Once the actuarial valuation results are approved, the valuation report will be issued. Then, GASB reporting will be completed between November and December 2022. Later, we will be providing alternate funding method forecasts for the next meeting in February 2023, or have a special meeting before February. Lastly, the mid-year estimated valuation results for budgeting for next year will be issued between January and February 2023.

A motion was made by Ms. Katherine Dodson to approve July 1, 2022, valuation results and seconded by Ms. Stacey Merritt. The vote was unanimous.

5. Next, Mr. Jon Breth of AndCo Consulting opened by presenting the "Investment Performance Review, Period Ending September 30, 2022, Executive Summary" for the quarterly performance review.

   The first 45 days of the quarter was favorable for equity markets and risk assets; however, the last 45 days did not fare well. Currently, long term inflation expectations are still very low. During this quarter, stocks and bonds were down 4.9%, and international stocks performed worse due to the U.S. dollar continuing to depreciate. Over the last year, there has been a significant decline in stocks and bonds; U.S. stocks down 15% and U.S. bonds down 15%. Small mid cap growth stocks performed well and fixed income market results were broadly negative during the 3rd quarter.

   Mr. Jon Breth moved on to Asset Allocation Compliance. We are in line with our long-term asset allocations, and continue to be moderately underweight to domestic equity and international equity.

   Mr. Jon Breth stated total funds for the quarter are down 5.5% due to asset allocation and managers. We added the Vanguard total stock market index fund, and kept the two value growth managers: Clearbridge and Alger. Sadly, they have generated low performance and frustration – Clearbridge is down 5% for the quarter. Alger is more aggressive in their portfolio, as they have more small and midcap stocks, which was down the first half of the year. Eagle Capital and DePrince are our deep value managers. Out of all the managers, DePrince held up the best this year. Jackson Square is down 7% and will be placed on watch due to their underperformance from last year and this year.

   Looking at international equity, Oakmark is a value manger and has been on and off the watch list. As they continue to underperform, it is recommended they be placed back on watch. MFS has continued to be an excellent manager within the structure of the portfolio. American Funds EuroPacific performed better this quarter. As we move into 2023, we will continue to evaluate if it is beneficial in having three managers within the international allocation.

   Mr. Jon Breth then stated Fixed Income was essentially in line with the U.S. market return. Within the U.S. market, we have three managers MetWest, JP Morgan and Garcia Hamilton. This quarter, JP Morgan has been less interest rate sensitive, thus yielding an outperformance. In contrast, MetWest and Garcia have been more interest rate sensitive through the second and third quarter. They were down 7% this quarter and due to global bonds, they face pressure from the U.S. dollar. Over the last year, the U.S. dollar has appreciated about 15%.

   Moving on to large cap growth managers, Mr. Jon Breth presented from the "U.S. Large Cap Growth Managers Analysis" - September 30, 2022. Clearbridge and Alger remain approved managers by AndCo, but the mangers faced a lot of pressure. Their performance was compared to other managers such as; DSM, MFS, Polan and Winslow over the last 10 years. Looking at fees, Alger and Clearbridge combined we are paying about 66 basis points. Clearbridge is 50 basis points and Alger is 83 basis points. Fees ranging from 32 for DSM, 49 for MFS, 60 for Polan and 45 for Winslow. The least consistent managers have been Polan and Winslow, as they have been able to outperform four of these years. The most consistent has been Alger and MFS outperformed 6 and 7 years. Clearbridge and DSM has been half and half. We want mangers that do not look like the benchmark.

6. Mr. Jon Breth then moved on to "Clayton County Employee Retirement System" Portfolio Discussion November 2022. Large Growth managers have had a hard time consistently beating the Russell 1000 Growth Index over the past ten years. Underperformance has come from broader diversification than the index, cash holdings, bias towards unperforming midcap holdings, and fees. Alger and Clearbridge are not alone in experiencing struggles against the benchmark. Clearbridge has been on watch for several quarters and Mr. Jon Breth recommends terminating them from the portfolio. If approved, this action will require a letter of termination (per their investment management agreement), alongside asking them to liquidate their portfolio in full. From there, it is recommended we take those liquidation proceeds and invest them into the Vanguard total stock market index fund.

   The second recommendation is to move forward with liquidating the Alger Capital Appreciation Fund and replacing it with the MFS Growth Fund. MFS has delivered more consistent annual performance, has achieved best risk/return, and will help lower investment management cost in the plan.

   Moving on to additional recommendations; Mr. Jon Breth wants to maintain DRZ's allocation because they continue to go a great job, and also recommends changing the benchmark for Eagle Capital from the Russell 1000 Value to the Russell 1000 Index. In summary, go from four large cap managers to three. MFS as our growth manager, Eagle as core manager and Deprince Race & Zollo as our value manager. This would reduce fees and improve our consistency with performance within the U.S.

   A motion was made by Mr. Jim Crissey to terminate Clearbridge Large Cap Growth, and move assets to Vanguard total stock market index fund. The motion was seconded by Ms. Katherine Dodson. The vote was unanimous.

   A motion to liquidate Alger Capital Fund and move proceeds to MFS Growth Fund was made by Ms. Katherine Dodson and seconded by Jim Crissey. The vote was unanimous.

   A motion to change Eagle Capital benchmark from Russell 1000 Value to the Russell 1000 Index was made by Ms. Katherine Dodson and seconded by Ms. Stacey Merritt.
   The vote was unanimous.

   A motion to place Jackson Square Smid Cap Growth and Oakmark International on the watchlist was made by Mr. Jim Crissey and seconded by Ms. Stacey Merritt. The vote was unanimous.

   Mr. Jon Breth continued his presentation by giving an update for October; we gained 4.5% down 1% for the fiscal period which is an improvement. We continue to see the market climb for November. October resembles what we saw in July with small cap markets doing well, although it was more value driven. The U.S. asset allocation performed in line with the benchmark internationally. Oakmark continues to demonstrate significant volatility, while generating outperformance alongside American Funds while MFS fell behind.

Lastly, Mr. Jon Breth pointed out year to date, we have experienced tremendous pricing pressure within the bond market. There are negative returns for all of our bond managers. On a pricing basis, we are seeing declines in the bond markets, but it does not mean we have permanently loss money within our bond portfolios. What it means is prices have gone down and as they mature, our managers are taking those maturities and reinvesting at higher interest rates. Within 15-18 months, we should start seeing healing in the bond market and especially within our bond portfolio.

Chairman Terry Hicks stated as long as you are not chasing a high interest rate by selling an existing bond at a low rate. Mr. Jon Breth responded for a traditional investor you are probably holding all the bonds to maturity. Managers have to weigh if they get enough on a new issued bond to make up for the loss if they sell the bond.

Mr. Jon Breth stated, for the meeting in February 2023, he would like to review the asset allocations to see if any changes are needed on the new assumed rate of returns. The one item that has driven fluctuation within returns is our reliance on the equity market. We have added a good piece with real estate and now will be the opportunity to tilt the portfolio slightly back towards the bond market due to the pricing improvement.

7. Kerri Hathaway requested approval of the quarterly benefits list:

   A motion was made by Ms. Pamela Ambles to approve the benefits as presented to the Board and seconded by Ms. Katherine Dodson. The vote was unanimous.

8. A motion to move to Executive Sessions was made by Mr. Jim Crissey and seconded by Ms. Stacey Merritt. The vote was unanimous.

   A motion to return to the Regular Pension Board Meeting was made by Ms. Stacey Merritt and seconded by Mr. Jim Crissey. The vote was unanimous.

9. A motion to consider any action from the Executive Session: to Deny the Application for Judge Shalonda Parker for the return of participants contribution; was made by Chairman Terry Hicks and seconded by Ms. Pam Ambles. The vote was unanimous.

10. Chairman Hicks opened the floor to discuss "Other Business" from the previous meetings regarding insurance coverages and asked Ms. Kerri Hathaway to give an update. Ms. Hathaway stated the Pension Board has been added to the County cyber security insurance policy.

11. A motion was made by Ms. Stacey Merritt to adjourn the Regular Pension Board Meeting and seconded by Ms. Pam Ambles. The vote was unanimous.

Clayton County Pension Board

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| Terry Hicks, Chairman | Date |
| Stacey Merritt, Interim Secretary | Date |