CITY OF PHILADELPHIA
SINKING FUNDS COMMISSION
Tuesday, October 1, 2019

\- - -

LOCATION: Two Penn Center Plaza
16th Floor
Philadelphia, Pennsylvania

REPORTED BY: Amy Marzario,
Court Reporter

PRESENT: DONN SCOTT, CHAIRMAN
AL JOHNSON
JERRY MANDIS
CHRISTOPHER DIFUSCO
ALEX GOLDSMITH
MARC AMMATURO
REBECCA RHYNHART
KELLAN WHITE
CHRISTIAN DUNBAR
DANIEL LEONARD
ROBERT CAWLEY

STREHLOW & ASSOCIATES
PHONE: (215) 504-4622
FAX: (215) 504-7155
COURT REPORTERS - VIDEOGRAPHERS
54 FRIENDS LANE, SUITE 116
NEWTOWN, PENNSYLVANIA 18940
WWW.STREHLOWCOURTREPORTING.COM

MR. SCOTT: It's my pleasure to call this meeting of the Sinking Funds to order. The first order of business is the approval of the minutes from July 11, 2019. Is there a motion?

MR. DUNBAR: So moved.

MR. SCOTT: Is there a second?

MS. RHYNHART: I can second it.

MR. SCOTT: The motion has been made and properly seconded. All those in favor?

MR. DUNBAR: Aye.

MR. SCOTT: Okay. The second order of business is the annual actuarial presentation so I'll turn it over to Mr. Johnson.

MR. JOHNSON: Okay. Thank you. Good to be here, everybody. I'm Al Johnson from Aon Corporation. Alongside me is Jerry Mandis who is a colleague of mine who works on the PGW account with me.

So this is our annual actuarial

evaluation report for PGW's pension plan. Its purpose is to provide you a snapshot of the pension liabilities of the plan as of July 1, 2019, the cash funded position of the plan as of that date, and the cash funding requirements for the July '19 through June 30th plan here based on the PGW policy -- the funding policy that PGW has adopted in the past. So that's what we're going to review here today.

Please flip over to page 1. I might jump around a little bit in this report so forgive me. Here is some basic information on the plan -- demographics of the plan from July 1 of '18 and July 1 of '19 as a snapshot.

So the first line is active participants. We had a decline in active participants from last year to this year. This has been a trend that this number has been in slightly decline as we go forward so this is going to be expected in the new hires. The new hires from PGW have the choice of going into the defined contribution plan or the defined benefit plan.

So what we're seeing is about four -- this year, we saw 55 percent joined the DB plan -- what I call the defined benefit plan, DB plan, and the other 45 percent joined the defined contribution plan. So for every 100, 55 went in here and 45 went into defined contribution.

MS. RHYNHART: And why are -- are the employees -- how is the union directing the employees? Is the union directing the employees to -- recommending one or the other?

MR. CAWLEY: Not to my knowledge.

MS. RHYNHART: Okay.

MR. JOHNSON: I would imagine that the union is probably encouraging their new members to join the defined benefit plan just because of --

MS. RHYNHART: That's what I was thinking.

MR. JOHNSON: -- the security

that it provides long term where the defined contribution plan, the investment risk lies with the employees.

MR. LEONARD: Yes, I would confirm what Al is saying.

MS. RHYNHART: But it's interesting to me that 45 percent are not joining the defined benefit. Is that because they don't plan to stay for that long? It's interesting.

MR. LEONARD: I don't know if whether their intention is whether or not they're going to stay. I know non-union employees are more leaning towards the defined contribution plan whereas union-covered employees are leaning more towards the defined benefit plan for the pension plans.

MS. RHYNHART: What's your breakdown for union and non-union?

MR. LEONARD: Roughly, we have about 1,000 to 1,100 union-covered employees with the remainder being non-union. So we roughly have about 400 to

500 non-union employees roughly.

MS. RHYNHART: Okay.

MR. DIFUSCO: Did that number change? I feel like for some reason within the last couple years it was more like two-third, one-third in prior reports from Tom. So has that number fluctuated at all?

MR. JOHNSON: That number will fluctuate year after year. I mean, you could have -- like any other actuarial assumption, you're going to have ups and downs on it. You're never going to quite hit it.

MR. DIFUSCO: Right.

MR. JOHNSON: We assume 50 percent on a long-term basis if that's what it's going to be. So our 55/45 is sort of in a range. Maybe next year that floats around. That's the other way.

MR. DUNBAR: Why are you assuming 50 percent?

MR. JOHNSON: Just based on the experience that we've seen in the plan. Roughly, that's where the split is coming.

MR. DUNBAR: Do you know if there's an added benefit to joining the defined contribution plan? Is there an added benefit; higher matching or something?

MR. LEONARD: No, it's actually the reverse. Any employee that chooses the defined benefit will have to contribute 5.5% of their salary.

MS. RHYNHART: Right. But does that --

MR. LEONARD: Or, excuse me, up to 6% of their salary.

MS. RHYNHART: Does PGW match that?

MR. LEONARD: No, we don't match that 5%.

MR. JOHNSON: No, I think he means on the defined -- the benefit plan.

MS. RHYNHART: Oh, okay.

MR. LEONARD: On the defined benefit -- so if an employee elects a defined benefit plan or selects a pension plan, they have to contribute up to 6% of their salary towards the pension plan. If they define -- or elect to choose a defined contribution, PGW will contribute I think 5.5% to their 401k.

MR. DUNBAR: As a match or just a --

MR. LEONARD: Up to 5.5%.

MR. DUNBAR: As a match?

MR. LEONARD: Yes.

MR. DUNBAR: Okay.

MR. LEONARD: So there's more incentive for the employees to elect the defined contribution plan than there would be the defined benefit.

MR. DUNBAR: Okay. That's what I'm trying to get at. That would explain it.

MS. RHYNHART: So the union is saying go defined benefit because you have the guarantee and then --

MR. LEONARD: Right.

MR. DUNBAR: In this assumption, 45 is not joining the defined benefit plan but does that mean they actually joined the defined contribution

plan or they're just not -- 'cause you can
have a percentage of them that aren't doing
anything?

MR. LEONARD: One or the
other.

MR. DUNBAR: You have to do
one or the other?

MR. LEONARD: Yes.

MR. JOHNSON: For our
purposes, we just want to know how many
people are coming into the defined benefit
plan. If they don't join, then that's fine.

MR. DUNBAR: I was just
wondering. So they have to do one or the
other?

MR. LEONARD: One or the
other. And an employee who joins PGW has up
to 30 days to select either defined benefit
or defined contribution. If an employee
does not make a selection after the 30-day
period, the employee will be automatically
enrolled into the defined contribution plan.

MR. DUNBAR: That could also
be another --

MR. LEONARD: Typically, we don't have too many employees missing that deadline so they either choose one or the other.

MR. SCOTT: So how is the employee educated on the two different plans?

MR. LEONARD: On their first day of arrival, or first week of arrival, we have employee orientation and our HR Department provides as part of the orientation two different plans and what is expected from them and what the difference is between the two plans.

MR. SCOTT: Does one plan enable you to get a lump sum?

MR. LEONARD: Not that I'm aware of, no. So when you say lump sum, what do you specifically mean?

MR. SCOTT: I've heard of DROP. I'm not sure what that is.

MR. LEONARD: No, we don't have the DROP at PGW.

MR. SCOTT: What I was asking

is once one gets to the retirement age, could they just say, Give me a million dollars and I'm out of here?

MR. LEONARD: No.

MR. SCOTT: So they have to take the benefits over time?

MR. LEONARD: They would have to take the benefits according to whatever the actuarial --

MR. DUNBAR: Someone in the defined contribution, you could make a larger withdrawal but you'll have significant tax implications associated with that, so a 401k plan like any other.

MR. LEONARD: From a 401, not from PGW'S pension plan.

MR. JOHNSON: But I imagine with the 401k, they can take their entire balance and roll it over --

MS. RHYNHART: Right.

MR. JOHNSON: -- where this plan does not offer that. We look at retired participants. They went down slightly as well. We had a higher number of deaths in that group than we would've expected to by our actuarial assumptions this year. And terminated investments is just a minor -- those are folks that have left PGW but have not begun to collect their pension as of these dates.

What we did see a pretty big decline in was the total payroll from last year to this year as well as average pay and these two items contributed a lot to the decline that we'll see on the next page in the contribution levels for PGW.

Last year and the year before that I believe, they went up fairly significantly, those two numbers. So maybe this year was sort of a balancing, you know. I think last year was like 9% which is quickly exceeding our 4.5% assumption. So maybe that's something like a corrective mechanism in place that got that back down to more normal levels.

Any questions on that section? That's a quick snapshot, again, fairly consistent year over year of what we would be expecting.

(No response).

MR. JOHNSON: Again, page 2, just a quick overview. The contributions this year have shown a decline. The primary drivers of that decline were that decrease in the cover of payroll in the average pay that we saw on the prior page, more retiree deaths than we assumed so we had an actual gain from that.

In addition, there was an adoption of an new mortality projection scale. We do this every year. Each year they change a little bit depending on the date that it's fed into that projection scale.

And this year, the scale reflects that people are actually living a little bit less than we thought they were going to live last year, so that brings our liabilities down.

MS. RHYNHART: In your mortality assumptions, do you assume going forward that people will live longer?

MR. JOHNSON: Yes. So

gradually, they will live longer as we go into the future. So it's not stacked. So if somebody who is 65 today is expected to live to 80. And in 20 years, somebody 65 might be expected to live to 82 or 83. So that's how that sort of works.

MS. RHYNHART: Okay. So it's very gradual?

MR. JOHNSON: It's continuously gradual built in on extra longevity. And that's built into our mortality date and the liabilities of the plan.

The net normal cost on the first line there, it had a drop of about 6.2%. The normal cost is just the value of the benefits accrued by the employees in a specific year. So if your plan -- if PGW's plan was 100% funded, that would be the annual cost of the plan.

So in this case, it would be about 7.3 million dollars. And that decline is due to those drivers that I just cited there that have worked positively this year. The contribution dropped as well from last year to this year.

PGW's funds, their past service liability over an open 20-year-period were a closed 30-year period. So as part of our projections, the 20-year level is what really controls for the first five or six years. And after that, the 30 year will overtake the 20 year and that will be a larger payment. So that's what we're seeing right now.

And then the percentage of payroll has declined as well because the payroll levels have declined and the contributions have declined as well. One thing I'd like to point out here is we've had this drop from 28.7 to 26 points, so about a two million dollar drop in the policy contribution. We don't know what's going to happen in the future.

My recommendation would be, and this is just from an actuarial perspective of somebody who looks to keep -- to get plans fully funded, is to continue to fund the plan at the higher rate, last year's rate, let's say the roughly 29 million dollars, rather than dropping down to the 26 million this year because we had these good experiences here but that's no guarantee that that's going to continue in the future. So getting more money in the plan is really in my mind good business practice.

And those higher contributions are already built into PGW's rate structure so the money is already there. So, again, this is just a recommendation but certainly one to discuss.

MS. RHYNHART: So the reason that the -- just let me understand this.

MR. JOHNSON: Yes.

MS. RHYNHART: The reason that it went down from 28.8 to 26.8, the two million drop, was because of the mortality change?

MR. JOHNSON: That was one piece. The other was the decline of the payroll. So we're assuming about a 4.5% increase in payroll each year and it went down.

MS. RHYNHART: So when you smooth that or when you do the whole calculation, you just ended up with a lower --

MR. JOHNSON: Right. And that reduction doesn't get all captured in one year. It gets smoothed out over that 20 or 30-year period but it does bring the contribution down two million dollars this year. Now, that's not to say that next year, the payroll goes up significantly again and then we're back at a higher contribution level.

MS. RHYNHART: Now, Dan, when PGW gets approval, you have to get approval from the PUC?

MR. LEONARD: That's correct. So when we filed our last rates back in 2017, the proposal that we had submitted to the PUC included the pension and the contribution to be approximately 28 to 29 million dollars so that's already included in our current rate structure.

MS. RHYNHART: And do you think that -- I mean, I don't want to put you on the spot with this. So it's already included in the rates? Is it PGW's plan to just continue funding it at that level?

MR. LEONARD: We typically plan at the higher of the two, the 20-year open amortization or the 30-year closed amortization. However, we have -- I guess since it's already embedded in the raise, we're prepared to contribute up to the 28.8 million dollars if directed by the commissioners -- or, excuse me, if directed by the Finance Director.

MS. RHYNHART: Are you the person that's the Finance Director's -- are you Rob's sub?

MR. DUNBAR: Yes.

MS. RHYNHART: Okay.

MR. SCOTT: So that's the Finance Director's decision and not PGW's?

MR. LEONARD: That's correct. That's what happened a few years back with paying the higher of the two, the higher of the open -- 20 or open vs. the 30 or closed. And if we are to contribute more than the actual determined contribution, that would be by the direction of the Finance Director.

MR. SCOTT: Why is total payroll anticipated?

MR. LEONARD: I don't think it was anticipated that full payroll -- it's not necessarily total payroll for the entire company. It's only those -- it's only applicable periods. So applicable payroll would be those employees that have been elected to be part of the defined benefits.

So to the extent that we have older employees that are leaving the company and joining the new pension plan, that doesn't include their salaries. And we have newer employees that are making a lower wage. Entering the defined benefit, that would only be one factor that would contribute to that decrease in payroll.

MR. JOHNSON: Any other questions on that page there?

(No response).

MR. JOHNSON: And, again, I don't want to step on anybody's toes with the policies here. I just think that, you know, we live in a world that's in highly variable markets going up and down unpredictably. And to have more money in the plan will just give the plan more cushion in the future as well as get towards being fully funded at a quicker rate.

MR. DIFUSCO: Al, you might get to this at a later page, and I've talked a little bit about this with Joe Golding and Dan. My understanding is that there's an expected -- you're planning for a larger number of retirements in the next 12 -- it was I'll say 12 to 24 months. That was going to be earlier and now it seems that's been extended for a year or so.

Like have you preliminarily, Al, looked at that? Is that one of the reasons you're recommending to keep the 28.8 that you're anticipating as kind of like, you know, a small spike in retirements?

MR. JOHNSON: That's one part

of it. I mean, you know, just the general
business practice is to just trying to get
more -- get additional funds in there. But
if we do have a spout of retirements, that
generally will increase liability and then
it's going to increase cost. So if we're
going to anticipate -- you know, I think the
union -- is the union contract coming up
soon?

MR. LEONARD: The union
contract is set to expire -- will be renewed
this May, May of 2020. So typically around
the contract time, either the December
before or the December after, we see a surge
in the amount of retirees for one reason or
another.

So we're anticipating that either
this December we're going to have an
increase compared to what trends typically
are or next December compared to what trends
typically are. It depends on, I guess, the
outcome of the contract.

Some people are fearful that the
contract would change. Therefore, we have a

surge in retirees the December before. And some people don't like the terms and conditions of the new contract so we have a surge of employees that are retiring after the contract.

MR. DIFUSCO: Okay. Thank you.

MR. JOHNSON: I'm going to turn over to page 3 if there's no more questions. Again, just stop at any point with questions.

So this year, what we call the unfunded accrued liability dropped about 7%, so going in the right direction. Again, all the factors that I cited about lower cover payroll and, you know, having more favorable experience on our actuarial assumptions.

So it's the 206 million is all liabilities of roughly 756 million so the plan is about 73% funded as of July 1, 2019. So we have about $0.73 saved for every dollar of future benefits that we owe. So we have to make up that gap either through investment returns or employer contributions.

Turning to page 4, we showed the market value and actuarial value of assets. A number of years ago, PGW implemented an actuarial value of assets to determine their contributions. What essentially that does is that smoothes market values over a five-year period. So you phase in 20% of the loss each year into the actuarial value of assets.

And over the period of the market value ups and downs, they all average out, keeping an asset value that's relatively smoother than a market value and making contributions more level as well. So that was a prudent step just to be able to make contributions, annual changes more predictable and not be subject to all 100% force of any market swings year over year.

And there is a 20% constraint so an actuarial value of asset cannot be greater than 120% or less than 80% of the market value so it keeps it somewhat in the neighborhood.

I just want to jump to page 12. A lot of those intervening pages are a lot of actuarial calculations. I don't know if anybody would be -- if anybody's interested in them, let me know but that's kind of the boring stuff.

We can jump over to page 12. Here is an estimated ten-year projection of the benefit payouts from the pension plan. And we can see it's based on the current age and service of the group and the size of their salaries and it's going to just gradually increase over time. This is assuming that all of our actuarial assumptions are met exactly in the future which we know that won't happen.

But for the purposes of these, you know, trends, that's how we do the calculations. So just gradually increasing about ten million dollars over the ten-year period.

MR. DIFUSCO: So, Al, the way to think about this is that about half the money every year -- at least based on the current payment schedule, about half the money is coming out of the fund itself to pay for benefits and then the other half roughly is coming, I mean, give or take, that the other half is coming from PGW's contributions?

MR. JOHNSON: Correct.

MR. DIFUSCO: 'Cause I'm used to, you know, paying -- and I update the commissioners every month but it's similar to, I would say, 2 or 2.5 million, sometimes a little lower, sometimes a little higher that were drawn from the funds --

MR. JOHNSON: Right.

MR. DIFUSCO: -- with the rest being paid by PGW?

MR. JOHNSON: Correct.

MS. RHYNHART: And then the employee contribution is a very small piece of that?

MR. DIFUSCO: A small piece of that. That comes in every so often and is immediately swept over into the cash account and then if prudent, reinvested. It comes in like monthly or every two to four weeks, something like that.

MR. JOHNSON: So the employee contribution is about 1.5% paid out but they're expected to rise to 6 --

MS. RHYNHART: Expected like it's already in the contract?

MR. JOHNSON: Yes. 'Cause all new employees have to pay that 6% employee contribution to be in the defined benefit plan. Employees I think before -- I can't remember exactly if it was 2011, they didn't have any employee contributions required in the plan.

MS. RHYNHART: Right.

MR. JOHNSON: All right. We can turn over to page 13. Here is a historical look back over the last eight years of PGW's funding progress and what's occurred along the way. So as you can see, we've had generally an increase in the funding levels.

And there's been a couple times where it was -- the investment return assumption was dropped based on market conditions and things of that nature. So we had some choppy waters there in 2015 and '16 where we lost some ground as we changed those assumptions to be more conservative.

But then since then, as the funding mechanism works, we're starting to build back up again so we're moving the plan slowly towards being fully funded. That's a bit down the road but that's how the method works here. So that gives you an idea of where you've been.

And if you flip over to page 16, here is a projection of where the plan is going. Again, this is a ten-year forward looking cash contribution forecast and how we can expect funding status to evolve over time. Again, this is assuming that all of our assumptions are met exactly in the future which we know won't happen.

But if they are, you can see a very gradual increase in the funding status of the plan from 72 to 78 over that ten-year period. And that's really due -- it is gradual because of the nature of how we're funding the past service liability over 20 and 30 years.

So it's going to take that amount of time to get to a fully-funded position but if our substances work out the way we think they will versus how we project the assets, the liabilities, and then the funding status of the plan to go.

MR. DIFUSCO: Now, this is assuming the 26.8, and if the Finance Director and PGW were to accept your recommendation to do 28, these numbers would move up most likely?

MR. JOHNSON: They would all move up.

MR. DIFUSCO: Do you have any idea how much?

MR. JOHNSON: I would say about half a point.

MR. DIFUSCO: Each one would move up half a point or would it add on? Each one individually or would it --

MR. JOHNSON: I would say

each one individually.

MR. DIFUSCO: Okay. So we'd go to like 73.1 just hypothetically if we brought in --

MR. JOHNSON: Correct. And the end there, that may come up a little bit more, maybe more towards the 80 if that was done. I mean, that's something that we can run out fairly simply and update and refresh the exhibits.

MR. DIFUSCO: That might be a good idea.

MR. DUNBAR: That's assuming the rate stays the same at 7.3?

MR. JOHNSON: Right. And in real life, we know there's going to be ups and downs. We saw it on the historical chart previously. You're never going to get that sort of steady increase. There's going to be bumps in the road along the way. But the way the funding method works is that you get those and eventually it gets back on track again to start moving towards 100%.

MR. SCOTT: So you projected

that we would be this year at X. Are we in compliance with your projections, slightly over, slightly under?

MR. JOHNSON: I think we were slightly over. So we did better because we had better experience than we anticipated. So we were probably about -- I think we estimated we were recommending 71.5% funded and we came in at at 72.6. So we did a little bit better this year due to those factors.

MS. RHYNHART: The information on page 12, is this provided anywhere where it shows the ten years going forward, the amount coming out of the plan? What Chris was saying, the amount coming out of the plan, projections to come out of the plan, the amount coming from PGW, and the amount coming from the employees so we can see how much is actually coming out of the plan, what the trends --

MR. JOHNSON: We can superimpose that. We could add columns to this if that's something that you want to see.

MS. RHYNHART: Okay. That would be helpful, yes. I would like to see that.

MR. JOHNSON: So you would like to see, just to clarify that, what PGW is expected to put into the plan?

MS. RHYNHART: Well, so out of this 56 million, that's coming from somewhere, right? That, you know, 26 to 28 million is coming from PGW, X amount is coming from employees, and X amount is coming from the plan itself.

MR. JOHNSON: Got it. Okay.

MS. RHYNHART: Okay, great.

MR. SCOTT: Did you say it was like 50/50?

MR. DIFUSCO: Excluding the employee contributions. I'm just putting those aside for the moment. I get that it would rise to 6. But, yes, I mean, on an average month and when you get the e-mails, you see somewhere between 1.9 and 2.5 million being gone out of the account, give or take.

So just quick math, right, times -- I mean, it's 45 to 55%, give or take. And then as Rebecca said, if we could get three columns that could break it down, you know, to be more precise? I would estimate it's about that.

MS. RHYNHART: PGW's contribution is actually showing a projected decline that's why I was asking.

MR. JOHNSON: In the projections?

MS. RHYNHART: Yes. So that's why if this -- if the expected payout is going up and then -- like I'm --

MR. JOHNSON: Right. The contribution is going down as part -- as the plan gets closer and closer to being fully funded, that contribution is going to continue to come down because there's no need.

Basically, what we're saying is the past service liability is going to be paid off so then all that will really be -- once the plan is 100% funded, really all you'll need to put in annually is what's called the horse --

MS. RHYNHART: The horse, right.

MR. JOHNSON: -- which is down to about 7 million. So, eventually, if we kept running this out, we'd get down to about -- it wouldn't be 7 'cause its normal cost is going to grow every year, but you would get down a level that might be more like ten million dollars.

MS. RHYNHART: So going back to page 12, there's more and more due to retirees. So the assumption is that the investment returns at 7.3% are going to pay?

MR. JOHNSON: That's right. What makes it up is the employer and employee money plus the investment return. That's one side of the equation. The other side is benefit payments and expenses that come out of the plan. Those two over the course of a plan's lifetime have to be equal to each other. It's just a matter of how we slice and dice it over the evolution of the plan.

The next two pages, I don't -- this is just showing what the contributions would be if we were just on the 20-year policy versus the overlay of the 30 year. And then the page after that is if we were just on the 30-year policy so just supplementary schedules. But really, the funding policy of the plan is on page 16 where we're showing that.

If we turn to page 19, the rest of the pages in here are really just some additional demographic breakdowns for the active participants, the retirees, and the terminated benefit folks. So it's just a way of giving you, you know, how folks are sitting.

If we turn to page 20, the active employees, there's service buckets on the top row and then their age is down the side. So there are -- at July 1, 2019, just to give you some idea, 16% of the population here is eligible for unreduced pension so those are the people that have exceeded 30 years of service, and an additional 5% are eligible for retirement.

So you have one out of every five employees here is eligible to retire. So that could be -- you know, if you had an outflow of people in a retirement situation, that could have a disruptive effect on the plan as well as just the operations of the organization itself. You're losing a lot of steam, your people with a lot of knowledge to retirement, that could have an impact on PGW itself, its internal operations.

And then just if we turn to page 22, here is a data reconciliation. So on the first page, I showed the snapshot at 7/1/18 and 7/1/19 and this is how we got from point A to point B. So it's the ins and outs in those particular -- in three different classes that we look at; actives, terminated investments, and retirees.

And then the last section is our actuarial assumptions and methods kind of lined out for you. The mortality table that we use is an industry table. It's published by the Society of Actuaries and it's based on current mortality for private sector plans so you're really using your most up-to-date mortality table here.

All the other assumptions are PGW specific so they're based on the experience of PGW employees. It's been about five years since we did an actuarial study of the assumptions and I'm going to recommend at the end of this year that we perform a comprehensive analysis of all of the PGW actuarial assumptions, confirm if we're -- validate whether our assumptions are still good or if we need to update our assumptions. So that would be the next item that I would propose that we do.

And any changes that I would recommend would first take effect for the July 1, 2020 evaluation. So this evaluation is complete which means it would be in the subsequent evaluation, we would be making the adjustments to assumptions.

MS. RHYNHART: Chris, how

often do we redo the experience to date for the City's main pension plan?

MR. DIFUSCO: I want to say every three years.

MS. RHYNHART: Every three? Right, that's what I thought. Five years is a long time.

MR. JOHNSON: Yes, I mean, the standard is -- generally, three to five years is sort of the range where five is starting to push the edge. Three is -- and if you have a lot of change going on, things are -- I would recommend doing it more frequently just, you know, to keep your eye on things.

But this plan I think is fairly uniform. We've had experience over the last five years that's been very close to what our assumptions are showing is correct. That's not to say each individual assumption is correct. That just says that in the aggregate, we're close to where we think we would be.

And that's why we haven't really --

probably don't want earlier but at the five-year mark, it's certainly time to do one itself. We'll put that on our to-do list for -- I think Q4 is when we'll get it done and then we'll review with you folks about the assumptions and the impact on cost and contributions.

MR. DIFUSCO: And there's certainly nothing, once you do it this year, to prevent PGW or the commissioners from saying three years from now or four years from now.

MR. JOHNSON: No, not at all.

MR. DIFUSCO: Certainly, I would agree. I mean, you talked about doing it this year. There's nothing from stopping us from doing it frequently.

MS. RHYNHART: Do we need to vote on that -- vote on doing it?

MR. JOHNSON: I wouldn't think so. This is something as part of my -- the stance and practice that I have to do this at some point.

MS. RHYNHART: Okay.

MR. JOHNSON: I mean, if you choose to vote on it, that's fine, but I don't think we need to.

And then the final section there is a summary of the plan provisions. So these are high-level summaries of benefits that employees of PGW are going for. Any more detail on that would be found on the plan documents.

I think that's about it from my perspective. Are there any other questions? I've got a couple takeaways.

MS. RHYNHART: I do have a question. I mean, this isn't in this presentation. It's in this book, the cash flow, which is right behind this green --

MR. JOHNSON: I brought copies of it with us. This is the 20-year projections that we had done.

MS. RHYNHART: This is just the cash flow. Well, it's ten years; 2018 to 2028. Do you have copies?

MR. JOHNSON: I don't have copies for everybody. We just made copies so we have some available.

MS. RHYNHART: That's okay. So the cash flow of this plan is really negative.

MR. JOHNSON: Yes.

MS. RHYNHART: So it goes from -- 2018, it goes from negative 4.7% and goes up to negative 6. I mean, this -- I wanted to just have a conversation around if there's a concern around that because -- and maybe there's not. Maybe there shouldn't be.

MR. JOHNSON: Are you looking at the one that says 7.3% annual investment --

MS. RHYNHART: Yes.

MR. JOHNSON: And there was one that also was 0%.

MS. RHYNHART: Yeah, I'm just looking at -- so, for example, on the City's main -- the City's pension plan, the big pension plan for fire, police, DC-33, and white collar and blue collar workers, we have a positive cash flow which comes from also -- I mean, the plan's very different. It's only 45% funded. It's a very different beast, right?

MR. DIFUSCO: That's a good word.

MS. RHYNHART: Yeah. So normally, I mean, you don't see negative cash flow below -- I mean, my understanding is also, oh, you want to see cash flow at negative 3% or better. That was what I've always -- you know, so you want to see that.

You don't want to see negative 4, 5, 6%. I don't know. I'm sure you do this for other places and other pension plans so I was wondering what you thought about if this is a concern.

MR. JOHNSON: Well, as I was mentioning earlier, I think, you know, higher employer contributions are better for funding a plan. You're going to -- what happens is as you see these going down, you're going to -- the plan will rely a bit more on investment income to make up, you know, for those gaps.

When you have a 0% rate of return, you can -- I think you have that one there as well, the net cash outflow is less than it is under the 7.3 because you're not getting any investment income so more employer money is coming into that plan. So it's going to offset that.

MS. RHYNHART: The PGW contribution goes to 47 million in that situation which I don't know what type of raise that would need.

MR. JOHNSON: And that's assuming that we're not earning any investment income going forward.

MS. RHYNHART: I just want to make sure we're all looking at it together because if there is -- because of the negative cash flow, if we don't hit a 7.3% return, that is going to go fly right to PGW to get -- to need an increase in rates. And so, I mean, there's -- I don't know.

Maybe you already talk about that and build that in to like what -- like okay, if you get a shock, if something like '08 happens again, you know, for one year, if we lose 30%, what do we need to go to the PUC for? And maybe you're already talking about that but I just want to make sure everyone's thinking about it to put it together.

MR. JOHNSON: So in this plan, you're relying more on investment income to make up the gap. So if you're balanced out, you're not as worried about ups and downs in the market because the money you have coming in is equal to the money you have going out. You're not relying on investment returns to meet any gaps because there aren't any gaps.

So that's just the -- that is going to be the nature of this, is that we're relying on that. So then if that net cash flow goes to negative 10 or negative 15, you're going to have normal reliance on that investment return. And if you have a bad year, it's going to be more and more of a shock to the system going forward.

It's why I always promote higher employer contributions to the plans and that's just my actuarial nature. My character is that, you know, I don't want -- it's a great investment income and these guys do a great job of it. But as we know, when the markets crash, it's not -- there's nothing Marc can do about when, you know, we have a complete meltdown.

But having a structure in place that's saying that, you know, the money coming in is equal to the money going out, we get that -- we're going to get that money back slowly but it's not going to affect our rates or affect contributions as much going forward. But that would take a, you know, decision to say maybe we want to fund this plan at 40 million a year. Now, that has to go into rates and --

MS. RHYNHART: Well, that's --

MR. JOHNSON: I know. But what I'm just saying is, you know, any extra dollars that go into the plan, that makes it more well-funded, it makes it a safer plan, and more able to withstand downturns and not

have very, very poor outcomes if those
downturns do come falling down.

MR. CAWLEY: Excuse me. Can
I interject for a second? I think it's a
question -- I'm Robert Cawley. I represent
the retirees, both union and non-union. I
think if we would lower our discount rate
lower than 7.3, that would give us a
cushion. We haven't had a serious
correction in a few years.

I don't think your actuary form --
I didn't see anything where you have like
one down here or over the next ten. You're
assuming we go up to 7.8 in the next. We
didn't do it in the last ten. We're exactly
where we were. I think -- you're saying
bring more money in from the employer at I
think a lower discount rate. So 7.3 is a
little higher than the national average.

MR. JOHNSON: That's
certainly another option.

MR. CAWLEY: 6.8 would be
fair. The company -- I think they're going
to have to have more money but that would be

a cushion to talk about.
MS. RHYNHART: Well, I think there should be a discussion around having a plan to lower it. I mean, that's -- you know. 7.3 is on the higher end of what's assumed.
MR. LEONARD: Can we go off the record?
MS. RHYNHART: I don't know. Are we allowed to?
MR. LEONARD: I don't know. I'm asking.
MR. DIFUSCO: Not with a quorum.
MR. LEONARD: Oh, okay. Never mind then.
MS. RHYNHART: I mean, we can continue the conversation next time. We can continue it next time. Do you want to just continue?
MR. LEONARD: Yeah.
MS. RHYNHART: Okay.
MR. JOHNSON: I think it's a good concern to raise though. I do

absolutely.

MR. SCOTT: Any other questions?

(No response).

MR. SCOTT: Do we have to take a form of action to accept this report?

MR. DIFUSCO: No. But when the revised copy, you know, comes back with the additions that your team is going to add, I'll distribute it to the commissioners electronically.

Assuming there's no further questions or requests for modifications or edits, then, you know, we can take the draft off after they've had a chance to look at it. And at that point, it would become --

MR. JOHNSON: And I'll get our signatures in there as well.

MR. DIFUSCO: Yeah. And once we know there's no further needs --

MR. JOHNSON: So we need another draft with the updates?

MR. DIFUSCO: Yeah. And then once we see that that's okay, then we'll say, okay, go ahead and take the draft off and sign it.

MR. JOHNSON: And we'll sign it. Okay.

MR. DIFUSCO: And we'll publish it on the website for everyone when it's done.

MR. JOHNSON: Perfect.

MR. DIFUSCO: Thank you.

MR. SCOTT: So there's an assumption that PGW's contributions going forward will remain the same? That's an assumption?

MR. LEONARD: I don't know. I'm not quite sure I understand what you mean by assumption. I think we're willing, with the direction of the Finance Director, to contribute up to the 28.9 million dollars. So we're willing to do that. We have the ability because it's already in our ways to do that.

MR. SCOTT: So you're saying it's a given?

MR. LEONARD: I'm not saying

it's a given. I'm saying we have to be directed. Currently, we're directed to contribute to the higher of the two. So to the extent that this is even more than the higher of the two, the 30 year closed or the 20 year open, we would need direction from the Finance Director.

MS. RHYNHART: They could use that two million for something else if we don't direct -- if the Finance --

MR. LEONARD: That's correct.

MS. RHYNHART: -- Director doesn't direct them, which isn't -- I would say that the rate payers are under the impression that they're paying for their pension with that. But anyway, the Finance Director needs to direct them.

MR. LEONARD: That's correct.

MR. DIFUSCO: So, Don, annually, the Finance Director will look at all the assumptions in the plan, the payments, the assumed rate of return, and then he gives instruction to PGW/the actuary/the commission. Like here are the changes that we're going to make this year or not.

And so if we were to change any of the assumptions, the assumed rate of return and the 28.9, he needs to send a letter basically determining those changes. It's not like the munie fund where the non-trustees around the table set the rate or set the assumptions. In this case, the legislation invests that according to the Finance Director.

MR. SCOTT: Okay.

MS. RHYNHART: I think that opinion was sent to me like day one on the job.

MR. DIFUSCO: Probably. I think you had a lot of stuff that day. I don't think that was the only thing they sent.

MR. WHITE: It was day five.

MR. DIFUSCO: In fairness, it was not a big pile of stuff.

MR. SCOTT: Okay. Thank you.

MS. RHYNHART: Are we doing

this -- the agenda?

MR. DIFUSCO: The asset allocation? I was actually just going to say --

MS. RHYNHART: I'm sorry.

MR. DIFUSCO: No, it's fine. So I had suggested, and I think I got some feedback from folks, that deferring the discussion on asset allocation, the proposed allocation alternatives in light of all the information we've considered today, the revisions that are coming from Al and his team that we would defer discussion and to vote on agenda item -- I guess it's four until November 13th. So we're going to remove that on the agenda and just move to investment performance.

MR. SCOTT: I wanted to ask one question.

MR. DIFUSCO: Sure.

MR. SCOTT: Rebecca, this discussion took place before you came.

MS. RHYNHART: Okay.

MR. SCOTT: And what we were

-- the question I asked was is there a requirement that we actually have an actuarial study? And Chris told me that from the City, yes, there is. But for PGW, there isn't.

MR. DIFUSCO: I said I haven't reviewed the legislation. I haven't had my counsel to the commission hat on many years. So I asked Adam and Ellen to check whether or not it's in the -- he's going to -- the law department is going to see what the legislation says and we'll pass that along.

I know in the Code there's specific reference to the -- it's either every year or every other year. I recall that. The PGW legislation I haven't looked at in a while.

MS. RHYNHART: Yeah, take a look at it and see.

MR. DIFUSCO: But Adam and Ellen will send something over.

MR. SCOTT: Okay. Thank you.

MR. DIFUSCO: But, yeah, we

have moved to something where we do it every
year. As you know, that was not always the
case in years past. But we'll get that
opinion after.

MR. DUNBAR: So are we
skipping on the asset allocation discussion
because we thought it would be too much in
conjunction with the report?

MR. DIFUSCO: Yes. And also
because if there's going to be discussion
about increased contribution levels and a
discussion offline with the Finance Director
about a lower superior return in the future,
that would impact, right? I mean, that
changes all the scenarios, right?

Suddenly, if you go to 7.2 or 7.1
or 7.15, that has a material impact on what
PFM and staff may recommend. So the idea
was let them present their revised report,
have the conversations with the Finance
Director, see if the increased contributions
are going to come in, and come back on the
13th with all of that like new and refreshed
information and discuss it then.

MR. DUNBAR: Okay.

MR. DIFUSCO: Is that --

MR. DUNBAR: Yeah, that's fair. I thought it was more of a discussion about the idea of alternatives and I'm sure over time, you know, those will get tweaked because this is going to always be an ongoing moving sort of -- moving target depending on what's happening in the market, depending on what's happening from a contribution perspective.

But I thought this was more of a discussion about the idea of moving towards alternative period and then we will always be making those adjustments, but we can certainly move it 'til November.

MR. DIFUSCO: Okay.

MR. SCOTT: All right. Well, the next item on the agenda is investment performance review.

MR. GOLDSMITH: Sure. Before I get into that, I want to say, you know, if there are questions related to the asset allocation related to adjusting the investment policy, you know, our views on what was discussed today, you could reach out on the next several months.

The last tab of the books includes flash performance for the month of July as well as the month of August. September has just ended so we don't have really a true indication of performance. We have a modern indication.

You know, very briefly, the first report here is for July. It was a good month of the plan; up 0.6%, outperforming its benchmark net of fees.

MS. RHYNHART: Where are we?

MR. GOLDSMITH: The very last tab. I'm sorry. The very last section of it.

MS. RHYNHART: I missed it, where the investment guidelines are changed here. Are we going to talk about that?

MR. DIFUSCO: That's part of the -- if you move to alternatives.

MS. RHYNHART: Oh, okay. Good.

MR. DIFUSCO: No, we're not changing anything. That's based on the current -- nothing is changing.

MS. RHYNHART: Okay. Thank you.

MR. GOLDSMITH: So, again, very briefly for July, you know, July was a good month for equities and stocks, U.S. stocks in particular. So that was largely responsible for the plan's outperformance. You get 0.63 versus 0.5 net of fees.

Additionally, very briefly on page 2 for the July report, there were some strong contributions from the credit and high-yield managers; Logan's Circle, Investment Grade Credit, and Sky Harbor pretty significantly outperforming the current place aggregate in the month of July.

Flipping ahead now through the green page, the provider page, now we're on to the Philadelphia Gas Works Pension Plan monthly performance review, month ended August 31st.

And then so August was a bit of a different overpersonal of the trend that we've seen most of this year with few exceptions. It was a negative month for equities if you just think back to where we started the end of July. We ended that month with the first cut to the Fed rates in ten years and an erosion of, you know, or I can say stepping back from the table of U.S. and China relating to trade discussions. So that's in equities.

You can see, you know, U.S. stocks were down 1 to 2% for the month of August. The plan as a whole was down for August, down 1.09% net of fees versus the benchmark which was down 0.63% net of fees. On a year-to-date basis, moving out several columns to the right, the plan is up 13.05%, so a very strong absolute return year to date. You know, adding to the experience I guess if you're looking at it from an actuarial basis. A slight lag in net of all fees relative to the benchmark 13.2, so 13.05 to 13.2 year to date.

Asset allocation, the overweight to equities, has been a net contributor to the plan while there has been some detractors on the active side as well as the overweight to small caps through August has been a detractor. And the fixed income component of the plan has an overweight to the intermediate fixed -- duration fixed income which more recently. You know, as fixed income markets become more volatile, that has been a detractor.

You know, so I'll just go back to the top. And moving through the individual sectors that, you know, combine large cap, you know, just behind the benchmark minus the 2.07 versus minus 1.83, most of that relied on PineBridge. They lagged for the quarter. They lagged by approaching 400 basis points year to date. That was a fund that was added at the end to being in 2018, 2017.

You know, we had a call with staff in PineBridge last quarter. You know, we're expecting their quarter-end information to arrive today and at which point make a determination whether they, you know, need to go on watch list or not. As of their August report, much of the underperformance year to date, really all of it was contributable to stock selection not sector allocation and really within one of their factors that they refer to as mature defensive.

So a lot of their selection within the mature defensive realm has been a detractor this year. You know, that's not entirely alarming given that, you know, their benchmark is up 18.3%. So, you know, while we do want to get a handle on why their defensive positioning is what's bringing them down in a sharply up market, that's less of a red flag than it would be if the market was eroding.

MR. DIFUSCO: Can we spend just another -- we did have that call and I know there was a lot of, you know, I think vigorous debate and discussion when we got rid of some of the other active managers.

These were obviously -- these folks were hired as low fee. I think they even described themselves maybe reluctantly as the enhanced index, right, when we hired them. And they do have a very low fee.

But, you know, I know we talked about -- look, they're in a really -- they're probably the most efficient space in the entire market, right? So if they were trailing index slightly -- I'm just curious to see what, you know, your research team and what you folks decide in terms of watch or where they're at because, you know, I'm not in favor of necessarily terminating managers too quickly.

But at the same time, the level -- and you know this 'cause we've talked about it offline, the level of underperformance given kind of what they're required to do, it is a little concerning. I'm sure the commissioners are on board and it is to me.

MR. GOLDSMITH: You're correct. We sort of classify that as their enhanced index. They do reluctantly like to, you know, say that. You know, they try to remain sector neutral when it comes to their portfolio positioning so no big overweights to consumer financials, et cetera. You know, I would say that their tracking error relative to the index has been a little higher than expected this year. And, again, that's been mostly attributable to individual selections.

So, just as an example, and this is over the last three months ending August, you know, one of their big contributors was an underweight to Philip Morris. At the same time, one of their big detractors was overweight to Altria Group. And so that is an example of, you know, the sector positioning hasn't changed.

They're in the consumer -- specifically cigarettes but their model is directing them to overweight one player relative to another. And, you know, the benefit in underweighting Philip Morris was offset from the overweight ot Altria. So that's an example of, you know, what is their model in directing within that one sector? So things like that have contributed to a higher tracking error this year.

And that's also I think maybe why they would sort of reluctantly call themselves an enhanced index. They will make bets between two companies like that. And so, again, we want to understand, you know, why this year their selection is off relative to prior years.

MR. SCOTT: What does the watch list mean?

MR. AMMATURO: A watch list means a manager that comes under closer scrutiny. The watch list means they're all on a track. If performance doesn't improve on an absolute or relative basis, termination's in the cards. So that's one step closer to termination and more scrutiny.

MS. RHYNHART: What's the downside by putting them on watch list?

MR. AMMATURO: I think we

want to hear the commentary that they have 'cause the quarter just ended, Rebecca. So we just want them to come to us with commentary, deep attribution analysis. Once we look at that analysis, we can make a conclusion whether or not watch list is warranted the next time we're together in November. The quarter just ended yesterday so we just want that time to do an analysis on the attributions.

MS. RHYNHART: So you're going to come next month? You would like to come next month -- to come back and say, Wow, it's doing --

MR. GOLDSMITH: We make our -- we have one defined ranking system and we make those decisions on a quarterly basis. You know, like Marc said, it just ended. So by the time the next meeting reaches, we would've already reached that decision and we'll be -- you know, we'll notify you as to where PineBridge is ranked at that time.

But that decision will be made at some point, you know, again, over the next three or four weeks as we -- as the information from the manager rolls in and we are actually able to speak with them following the end of the quarter.

MR. AMMATURO: And to Alex's point, if the models tell them to select high-quality stocks, that has not been the place to be. When the market's up 18%, high-quality stocks usually don't keep up in a month that's up 18%. So that's probably very telling if that's what the models say. We'll take a deeper dive, obviously.

MR. GOLDSMITH: And, again, at the same time, you know, they did underperform just for the one-month period. You know, the stocks were off this month. So that's why we want to, you know, basically create a designation. It's not so much for us but also for you, to remind you that this is where we stand here.

I mentioned small caps. You know, for the month, you can see the combined small cap. Active management, particularly, you know, Copeland, the newest manager, was doing quite well while the sector was down. Year to date as a whole, small caps lag the broad U.S. stock market and that's a trend that was reversed by, you know, a fairly large magnitude here in September.

The small cap stocks outperform large caps by as much as 2% in the month of September. So that weight's going to have to benefit the plan when we see the flash in ten days. International equity, down 3.3% relative to the benchmark down 3.09 net of fees, largely related to Acadia.

You can see for the month they missed their benchmark, you know, by a valid percent. Similarly to PineBridge, they are a quantral manager. They've only been in the portfolio about two months at this point. So, you know, they've continued to build out their positions. Within fixed income for the month, you can see the top there, 2.14 versus the Barklay's aggregate, 2.59, nearly 2.6.

You know, the active contribution from the core and, you know, investment grade credit managers was positive but not a magnitude to offset the underperformance caused by the intermediate managers. So when I'm talking about that, I'm talking about Lazard and Garcia Hamilton, you know, towards the bottom there. They're benchmarked to be -- Bloomberg Barklay's intermediate in the intermediate group.

So you can see, you know, while they outperform -- was already outperforming as a benchmark, Garcia Hamilton was slightly behind. But, you know, their benchmarks as a whole underperformed the Barklay's aggregate by merely a percentage point and that's a trend that's persisted year to date.

You know, from an active standpoint, they've done well but it's a question of, you know, do we want to continue to maintain an allocation to this intermediate sector of the bond market? That's one that's been, you know, in place quite a while here. As we move through the RFPs, we've tackled a number of the themes in large cap, small cap, international equity.

You know, I think the next thing we tackle is a simplification of the fixed income through the issuance. It's more of these consolidations and a determination of do we want to, you know, retain this if we hit?

You might recall we've made a decision over the last two years to add investment grade credit, to add high yield which over that time has been beneficial, you know, after which is the next step to the fixed income portfolio.

I'll pass a number of -- we have -- updated as of September 27th, you can see the market value as of this time, $550,836,605. And maintaining, you know, again, if you look at the column titled The Allocation Difference, it's the fourth column to the right, maintaining an overweight to equities, underweight to fixed income.

Given the performance -- relative

performance of the asset class this year has on a whole benefited the plan. You know, we don't -- our views haven't changed. We don't see a recession in the next six to twelve months. You know, consumer spending remains strong.

You know, I didn't really go into the Rhumbline company a great deal but we have accommodated a Federal Reserve policy at this point and we continue to favor the stock markets over the bond markets for the near to intermediate term.

I'll open it up to questions at this point for our views on the positioning of the plan, no recommendations at this time, we changed the asset allocation. You know, we'll have a greater discussion on that in a few months.

(No response).

MR. SCOTT: Do we have any new business that we want to discuss at this time?

MR. DIFUSCO: Just a couple real quick announcements. And I'll be cautious 'cause we have the vendors in the room.

So I'm working through the Custodial Bank RFPs. I met with one of the applicants. I'll meet with another tomorrow and then I'll meet with the incumbent I think in about another week. My goal is to have a report and a finalist or finalists to present no later than the January meeting.

Once I'm through that report, then I'll turn my attention to the RFP in the process for an investment consultant. That contract ends March 31st of next year so I'll turn my attention to the RFP selection process for that. And I'll keep the commissioners certainly updated either at the meetings, or depending on the information, through e-mail or offline communications.

MR. SCOTT: All right. Is there a motion to adjourn?

MR. DUNBAR: Before we do, I would like to address quickly -- to congratulate my colleague, Alex, for recently getting married.

MR. GOLDSMITH: Thanks.

MS. RHYNHART: Congratulations.

MR. GOLDSMITH: Thank you. It was a very city-focused wedding, very Philly. We got married over the Penn campus and it was a nice party downtown. Thanks, Christian.

MR. DUNBAR: So with that, I make a move to adjourn.

MR. SCOTT: So moved. Thank you.

\- - -

(This concludes the meeting at 11:10 a.m.)

\- - -

C E R T I F I C A T I O N

I hereby certify that the proceedings and evidence noted are contained fully and accurately in the stenographic notes taken by me upon the foregoing matter dated October 1, 2019 and that this is a correct transcript of the same.

Amy Marzario
Court Reporter - Notary Public

(The foregoing certification of this transcript does not apply to any reproduction of the same by any means, unless under the direct control and/or supervision of the certifying reporter.)