

Sinking Fund Commission Quarterly Meeting
September 14, 2016

CITY OF PHILADELPHIA
SINKING FUND COMMISSION

In Re: Quarterly Meeting

- - - - -

Wednesday, September 14, 2016

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This Meeting of the Sinking Fund Commission,
held pursuant to notice in the above mentioned
cause, before Angela M. King, RPR, Court Reporter
- Notary Public there being present, held at Two
Penn Center, 16th Floor Conference Room on the
above date, commencing at approximately 11:00
a.m., pursuant to the State of Pennsylvania
General Court Rules

- - -

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September 14, 2016

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1 A P P E A R A N C E S

2

3 COMMISSION MEMBERS:

4 Donn Scott, Chairman

5 Alan Butkovitz, Controller

6 Christian Dunbar, (Sitting in for Treasurer)

7

8 ALSO PRESENT:

9 Matthew Mazza, Executive Director

10 Christopher R. DiFusco, CIO, PGW

11 Marc Ammaturo, PFM Asset Management

12 Alex Goldsmith, PFM Asset Management

13 Bill Rubin, Deputy Controller

14 Ellen Berkowitz, Deputy City Solicitor

15 Adam Coleman, Assistant City Solicitor

16 Also Present: PGW Reps - Dan Leonard and Joe

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2 CHAIRMAN SCOTT: Good morning, everyone.
3 My pleasure to call the meeting of the Sinking
4 Fund Commission to order. Thank you all for
5 coming out and joining us this morning.

6 The first item on the agenda is the
7 approval of the transcript of the meeting on
8 July 13. Is there a motion?

9 MR. DUNBAR: So moved.

10 MR. BUTKOVITZ: Second.

11 CHAIRMAN SCOTT: Motion has been made
12 and properly seconded.

13 All those in favor say aye.

14 (Chorus of Ayes.)

15 CHAIRMAN SCOTT: Opposed?

16 (No response.)

17 Ayes have it. All right.

18 The next item on the agenda is the PGW
19 Pension Plan Investment Consultant Report.

20 MR. AMMATURO: Thank you, Mr. Chairman.
21 Everyone has a copy now, the August update in
22 front of them I assume. It's not in the spiral,
23 just handed out separately. We just produced
24 this since the one in the book is July. We

1 figured we'd talk about August.

2 At the end of August, your plan market
3 value was 492,225,556. For the month, positive
4 monthly return of 36 basis points. For the most
5 recent three months ending August 31, a positive
6 4 percent. For the fiscal year, return of 7.53;
7 and a year-to-date, a calendar year-to-date
8 return of 6.65. So taking a step back from the
9 numbers, it's been a pretty solid year for asset
10 classes across the board.

11 Through August, the domestic stock
12 market was up about 8 percent. If you look
13 overseas, the developed markets were actually
14 flat through August. But emerging markets were
15 up 15 percent. And if you look at the bond
16 market, which we will get to in a second, it was
17 up about 6 percent through August. So across the
18 board, asset classes have done very well, again,
19 through the month of August. And you can see
20 that reflected in your total fund returns.

21 And even if you look down like one year,
22 three years, your numbers are right around 7 and
23 a half percent annualized, again, as of
24 August 31. I think you are all aware of what

1 your goal is here. Your goal is to meet your
2 actuarial assumption, which is 7.3 percent. And
3 your five-year number is well north of that,
4 around 8.5.

5 So going down each individual asset
6 class at a high level, I'll make some remarks.
7 But your first bucket is large cap. The bolded
8 row is how all these managers in large cap have
9 done in the aggregate, so it's rolled up. If you
10 look at the year-to-date column, 6.65. Again
11 year-to-date for the ending August, 6.65. It
12 actually trails the Russell 1000. The Russell
13 1000 is the benchmark for large cap domestic
14 equity. Again, trails it at 6.6 verse 7.8.

15 Why? Look at the bottom two managers in
16 that bucket. O'Shaughnessy, year-to-date 7.3
17 verse 10.2. And look at Fred Alger year-to-date
18 up 2.2 versus a benchmark of 5.6. Your two
19 active managers are not keeping up in this up
20 market in the domestic stock market.

21 Why is that? O'Shaughnessy has big
22 sector bets in their portfolio. You know,
23 they're all about stock selection. They're
24 agnostic when it comes to sectors. And if you

1 look at their sectors, they have no exposure to
2 utilities. Utilities were up 16 percent through
3 August. And they are also overweight
4 industrials, which has been -- which has been a
5 head wind.

6 So, we're keeping a close eye on them.
7 One thing you should be aware of, though, there
8 is a large cap core RFP that's been posted. You
9 may recall in meetings past we talked about why
10 not dampen volatility as opposed to adding growth
11 in value in higher core, large cap core manager.
12 Again, that's in process. It's been posted. We
13 will see how that plays out going forward. And
14 you know, they just got hired here. They got
15 hired toward the end of last year prior to PFM
16 coming on board. If you look all the way to the
17 far right, they got hired in November as of last
18 year.

19 Fred Alger, again, that's the other
20 culprit in terms of underperformance for the year
21 in domestic equity. They have a big bet on
22 Google. Google sold off in the second quarter.
23 It was negative for the second quarter about 6,
24 7 percent. Google is about 7 percent of the

1 portfolio. That was a headwind for the three
2 months ending June for sure.

3 In the small cap arena, if you look at
4 the year-to-date, this is all the small cap, year
5 to small cap managers rolled up. Look at
6 year-to-date, up 7 and a half percent. The
7 benchmark up 10 percent. Vaughan Nelson is the
8 culprit here. If you look at year-to-date again,
9 is up 9.9. The benchmark is actually up 14 and a
10 half.

11 Vaughan Nelson's longer term numbers are
12 strong. If you look at the three year, five year
13 since inception, they are all in excess of the
14 benchmark. But this year they are being hurt by
15 specific stocks in the financial and IT sector
16 that held their relative performance back on the
17 year-to-date. Again, longer term numbers, they
18 added value to PGW since you hired them back in
19 2011. If you look up all the way to the far
20 right, up 10.6 verse 8.6. So that's, again,
21 since PGW hired them back in 2011, 2 percent of
22 that performance.

23 Eagle's benchmark life for the year, 5.3
24 versus 5.9. If you look all the way to the far

1 right, they have been in your portfolio for quite
2 some time, as well. They got hired back in 2009.
3 They've also added value, 15.05 versus 14.12.

4 Good performance in international
5 equity. So, little bit different story than
6 large cap and small cap. You look at
7 international equity, you look at year-to-date
8 column, significant outperformance, 9.48 verse
9 4.5. Everyone sees where I'm looking at for the
10 year-to-date? So good alpha or incremental
11 return generated by your active managers,
12 actually, every single manager: Mondrian,
13 Harding, PFAs on a year-to-date basis have all
14 added value. Actually, if you look to the far
15 right, they've all added value since they've been
16 hired by PGW.

17 Mondrian and Harding both had strong,
18 strong stock selection in Japan and the UK. And
19 Harding's exposure to emerging markets has also
20 been beneficial. Harding has about 15 percent
21 over Philly in emerging markets. Again, I
22 mentioned this when I started off. Developed
23 markets overseas through August are flat.
24 Emerging markets are up 15 percent through

1 August. And then you see your dedicated emerging
2 markets manager on the bottom. So, all they do
3 is invest in emerging markets. And it can be
4 very volatile, but so far so good in terms of
5 calendar year returns. You look at 16.8 percent
6 positive. That's only about 4 percent of your
7 portfolio.

8 They have a big overweight in Brazil,
9 DFA does. Brazil, believe it or not, is up
10 60 percent year-to-date through August. Was
11 negative 40 percent last year, but it's positive.

12 MR. BUTKOVITZ: How much of that is
13 because of the recent impeachment in the last
14 month or so?

15 MR. AMMATURO: Yeah. That's a lot of
16 it. There's a lot of sentiment that the
17 impeachment of the leader leads to a positive for
18 the markets. So, a lot of sentiment leading up
19 to his impeach -- her impeachment which has taken
20 place. So that, undoubtedly, part of the
21 rationale for the upswing in the Brazilian stock
22 market as well as the prices stabilization.

23 MR. BUTKOVITZ: Opposition leader was
24 just removed for corruption who led the

1 impeachment. Damned if you do, damned if you
2 don't.

3 MR. AMMATURO: Exactly. It's tough to
4 get your arms around this political sentiment
5 that drives markets. We tend not to do that.
6 Without a doubt, political sentiment drives
7 markets in emerging countries at times. That's
8 not for long term, but definitely pockets where
9 political sentiment will drive markets.

10 MR. BUTKOVITZ: Was the negative
11 performance in Brazil also because of politics or
12 was the fundamental direction down?

13 MR. AMMATURO: I would think the
14 negative return last year was more driven by the
15 drop in oil. So, there was a lot of commodity
16 producers in Brazil needless to say. And the
17 volatility and the price of oil last year led to
18 some profit margin being squeezed and some of the
19 Brazilian domicile companies. Now the price of
20 oil has more stabilized. One can argue that's
21 helped the companies domiciled there.

22 MR. DiFUSCO: And -- I'm sorry. And
23 then also, just keep in mind we did -- the
24 Commission did hire an index manager for the

1 international space at the last meeting. I had
2 sent an email to the Commission about that a week
3 or so ago in terms of upgrading the platform with
4 Wells Fargo. So once that is complete and once
5 the contract is complete with Rhumbline, then to
6 the extent there is recommendation to shift
7 assets to index fund, we will be in a position to
8 do that.

9 MR. AMMATURO: Thanks, Chris.

10 MR. DiFUSCO: Sorry about that.

11 MR. AMMATURO: No, thanks.

12 So in fixed income on the flip side, I
13 guess to continue with Chris' point, there is a
14 RFP out there -- actually, two RFPs outstanding.
15 One is investment grade credit and fixed income,
16 investment grade credit, and the other one is
17 emerging market debt. Again, they are both
18 outstanding.

19 The investment grade credit RFP,
20 responses have been received. We will be going
21 through them with staff here going forward, but
22 just to close the loop on outstanding RFPs and
23 potential changes going forward.

24 But in fixed income, performance is

1 fairly solid. If you look at year-to-date, 5.4.
2 The benchmark is up 5.8. Very benchmark-like
3 performance. What's helped here is the
4 overweight credit.

5 If you look at Weaver Barksdale,
6 outperformed. If you look at Logan Circle,
7 outperformed. I'm looking at the year-to-date
8 column. They are both overweight corporate bonds
9 relative to benchmark. And credit has been a
10 place to be so far in 2016. Logan Circle
11 actually has some high yield. High yield has
12 done really well this year. They have about 5
13 percent of their portfolio in high yield.
14 There's no high yield in the benchmark.

15 So that corporate overweight for Weaver
16 Barksdale and Logan Circle has undoubtedly helped
17 them. If you look at the year-to-date column,
18 they are both outperforming. Similar story for
19 Lazard and Garcia Hamilton. Again, looking at
20 year-to-date, both have slightly outperformed for
21 different reasons, especially Garcia Hamilton.
22 Garcia Hamilton is more of a mortgage and agency
23 manager, but they have done well in security
24 selection. And again, you see the

1 outperformance.

2 For the majority of these managers,
3 fixed income, if you look across one year or
4 three year, they've consistently added value
5 relative to their benchmark. If you go all the
6 way out to the far right since inception, Weaver
7 Barksdale, 5.91 verse 5.47; Logan Circle, 4.04
8 verse 3.69; Lazard, 3.4 verse 3.1; Garcia
9 Hamilton, 4.2 verse 2.9. Good incremental return
10 being generated by these active managers in fixed
11 income.

12 That was a pretty quick overview of your
13 portfolio. There is no recommended changes at
14 this time. Again, your portfolio year-to-date is
15 up 6.65 through the month of August.

16 CHAIRMAN SCOTT: Thank you very much for
17 the report.

18 Actuary Report, Tom.

19 MR. VINCENTE: Does everybody have a
20 copy? I brought some extra if you need it.

21 (Passes around copies)

22 Just as we get into it, this is the
23 annual review of the plan from an actuarial
24 perspective. This report is designed to update

1 the pension liabilities as of June 30 of 2016,
2 which computes the cash funded position as of
3 June 30, 2016, and projects out the cash
4 contributions requirements for the coming year,
5 the funding policy adopted by PGW for the plan.
6 We will get into the specific pages.

7 But just as an overview, there were two
8 big movers to the numbers this year versus last
9 year. One is that the actuarial assumption
10 around long term rate of return was moved down
11 from 7.65 percent down to 7.3 percent. That had
12 a material impact on the liabilities. We are
13 using that same percentage to discount the future
14 payment streams back to today's dollars. And
15 that 35-basis point change does have a material
16 impact on the liability numbers.

17 The other item having impact was that as
18 opposed to nice numbers that we just heard about,
19 the period ending June 30 was not as robust. And
20 the returns for the year in June 30 did not hit
21 the 7.65 actuarial assumption from prior year.
22 We underperformed from that basis. And so, we
23 have an actual loss there. Those are the two
24 item that contributed to the results this year

1 making the plan somewhat more underfunded than it
2 was.

3 The good news is from a demographic
4 standpoint, that is what happened with salaries,
5 what happened with turnover, retirement patterns,
6 hiring patterns, those all were overwhelming
7 within what we considered normal patterns. We
8 were off by what we expected to be by less than 1
9 percent. Generally speaking, with a group this
10 size, a deviation of plus or minus 3 percent is
11 usually considered within the norm. We were less
12 than 1 percent off. From a demographic
13 standpoint, that all seemed to match pretty well.

14 MR. RUBIN: How does that -- when you
15 look at the comparative summary principal
16 evaluation results that says 4 and a half percent
17 on the total payroll?

18 MR. VINCENTE: So 4 and a half was a
19 change in the payroll from year to year. But
20 what that is telling us is that we are expecting
21 to see a decline in payroll from year to year.
22 Because of the way this plan is structured, the
23 way PGW is structured right now, when new
24 employees are hired, they are given the option of

1 joining this plan or joining a defined
2 contribution plan. About one third or so up to
3 40 percent of the folks that join this plan
4 versus those who join the defined contribution
5 plan. We are expecting over time for there to be
6 attrition in this plan.

7 MR. RUBIN: So then, that means our
8 numbers are going to go upside down, right? So,
9 we are going to have a lot more people that are
10 going to be looking to collect a benefit and a
11 lot less going in.

12 MR. VINCENTE: Correct. We are already
13 in that position. If you look at the top of
14 that, Page A, the comparative summary of
15 principal evaluation results, we have 1,251
16 active participants currently versus almost 2,200
17 retired.

18 MR. RUBIN: Do we have a chart that
19 tells us when we think that's going to be a major
20 issue that we should be planning for now?

21 MR. VINCENTE: Well, we are planning for
22 it now in that the cash funding structure is
23 designed to bring the plan to full funding over a
24 20-year period. That that's what we are funding

1 right now. So that's -- where it becomes a major
2 issue, and right now when we got to the
3 contribution section, that's what we are
4 contributing. And I guess major issue is hard
5 for me to say. The contribution is a percentage
6 of this payroll is very high. If we want to just
7 turn to the next page where we have the
8 contributions, that the 20-year contribution is
9 32 percent of the payroll.

10 So to me, if I was sitting here -- if
11 that was my whole budget, and I was paying 32
12 percent towards pension, I would think that's a
13 pretty stiff percentage of my overall budget.
14 But knowing that this payroll is not the full
15 payroll of PGW can temper that a little bit.
16 Probably the thing that says to me as an actuary
17 is that assuming the resources of PGW to finance
18 this plan are somehow parallel to that payroll
19 level and these contribution levels, it would
20 mean that we are probably more sensitive now to
21 adverse investment results than we ever have been
22 in the future. Payroll changes. Sometimes in
23 the past, things like a big jump in payroll would
24 have been big driver of pension cost changes.

1 That is going to be much more minimal now given
2 the way the demographics of the plan are. And
3 are much more sensitive to movements in
4 investment returns.

5 MR. RUBIN: Would it be fair to say that
6 this group is being proactive knowing that that's
7 going to come later, and taking proper actions to
8 make sure that we're able to fully fund the
9 pension?

10 MR. VINCENTE: I think so. PGW has
11 always made the recommended actuarial
12 contributions. There's been no skipping of the
13 contributions. We making the assumed rate of
14 return of the future more conservative at 7.3 is
15 a good step, as well. We are not overstating
16 where we think things are going to go. We are
17 staying current with long term rates of return
18 are.

19 It looks like from review we just went
20 over, we are still around 60 percent, in return
21 seeking assets about 30 percent in fixed income.
22 I'm not sure where that puts us in terms of
23 sensitivity to returns. Certainly varies by the
24 type of investments that are there. We are

1 protecting ourselves somewhat by adopting a more
2 conservative set of assumptions around investment
3 return of 7.3. Certainly, not the lowest in the
4 country at 7.3, but we are moving -- by doing
5 that, moving to a more conservative posture.

6 Just back on the first page, this is
7 a -- other items to point out. As was mentioned,
8 the total payroll is down about 4 and a half
9 percent. The actual participant count is down
10 about seven-tenths of a percent. Generally
11 speaking, what we are saying there is that the --
12 retirees will -- numbers will change as folks
13 pass away replaced by new retirees, which are
14 invested. Those are folks who have left PGW.
15 Not yet elected to start their pension. That
16 number is relatively small. Indicating most
17 individuals stay to retirement, and the number of
18 active participants is shrinking. And we do
19 expect that number to gradually wear down where
20 eventually it will hit point of stability at some
21 point with the replacement patterns we are
22 seeing.

23 MR. DiFUSCO: Do you have an idea for
24 that?

1 MR. VINCENTE: I have not run those
2 figures, no.

3 MR. MAZZA: In terms of the average age,
4 Tom, in terms of other pension plans you cover,
5 where do we fit in? Do we have younger folks in
6 our plan?

7 MR. VINCENTE: It really depends who you
8 compare yourself against. If you look at general
9 population, the 44 -- almost 44 and three-quarter
10 age is not that different. Probably a hair
11 younger than we see in a lot of public sector,
12 governmental organizations where you tend to have
13 a lot of long service folks who stay for a long
14 period of time. If you compare it to a public
15 safety type plan, then you will see your age is
16 probably a little bit higher because public
17 safety tends to be a younger group.

18 This group does have a relatively early
19 retirement age at 60/62. A lot of folks do got
20 out at that age, which keeps average age on the
21 other side.

22 MR. RUBIN: That factors in your 30 and
23 all, as well?

24 MR. VINCENTE: Yes.

1 MR. DiFUSCO: Just one other question.
2 You mentioned increased sensitivity to investment
3 returns. You may recall, I'm sure you recall a
4 couple years ago we had unexpected spike in the
5 number of retirements which had a huge downward
6 impact on the plan.

7 How vulnerable do we remain if we had
8 another situation like that where if your numbers
9 were significantly off, we had an unforeseen rush
10 to the exits or something? How vulnerable are we
11 in terms of fund level to kind of an event like
12 that?

13 MR. VINCENTE: So the active group --
14 just take a quick look here. The active group
15 makes up about a third of the total liability.

16 MR. DiFUSCO: Okay.

17 MR. VINCENTE: So if that group were to
18 increase liability say 20 percent, that's
19 20 percent on a third. So what's that? That's
20 about 8 percent increase in liability.

21 MR. DiFUSCO: Okay.

22 MR. VINCENTE: Liability is pretty big.
23 If you want to call that an \$8 million -- the
24 liability itself is about \$800 million. So if

1 you said it was a 10 percent increase in
2 liability overall, that would be \$800 million
3 that had not yet been funded for. Essentially
4 with this plan, there is a -- there is -- we are
5 funding based on assumption that people go out in
6 a certain pattern. If they accelerate the
7 retirement, we have less time to fund for them.
8 We are funding more quickly.

9 That's what's going to happen in this
10 case. We are making payouts earlier. The early
11 time reductions are not -- not enough of an
12 offset to the accelerated payouts. That's why we
13 have extra liabilities to fund.

14 MR. MAZZA: Any recommendations to
15 increase cash distribution to prevent against
16 something like that? Or think our cash
17 distribution is fine?

18 MR. VINCENTE: I think our cash planning
19 position, I believe PGW, when I talk to folks
20 there in human resources, they have a good handle
21 on when people retire. People generally give
22 them notice on a fairly regular basis. They have
23 a good sense for how that's going. They are well
24 aware a couple years ago that that spike was

1 occurring and why. They -- actually, I talked to
2 them a couple times recently about what they're
3 seeing now. They are not seeing any sort of
4 continued spike there. It's really more back to
5 business as usual.

6 Usually with different groups, when the
7 parts of this group is covered by union
8 contracts, depending on how the union contract is
9 negotiated, how long sometimes the contracts run
10 out. And they are usually waiting for the new
11 contract to expire to be updated. Sometimes you
12 will see a pause in retirement in those
13 situations, and then there's a catch up on the
14 new provisions are known. As far as we know at
15 this point, that is not an issue. We are not
16 seeing a new backlog. We are not aware of
17 backlog occurring.

18 MR. MAZZA: I am just bringing that up
19 because the spike that we had, there was nothing
20 guaranteed in that. That was just pure
21 speculation. So speculation happens again, just
22 want to make sure.

23 MR. VINCENTE: Right.

24 MR. RUBIN: Sounds like what you are

1 saying is they are monitoring that and they know
2 the pool of people that would be eligible.

3 MR. VINCENTE: Right.

4 MR. RUBIN: I would think -- what's the
5 contract, another two years before --

6 MR. LEONARD: Yes, 2019.

7 MR. RUBIN: '19? I guess '18 going into
8 '19 where we might see another spike.

9 MR. LEONARD: We would expect to see a
10 spike in December of 2018 in the calendar year if
11 there were to be a spike.

12 MR. RUBIN: We can plan for knowing that
13 that might be the time.

14 MR. VINCENTE: And the retirement rates
15 we use in this, we use assumption about when
16 folks retire based on age and their service.
17 That's based on gathering information over
18 several years, which should include various other
19 spikes. We did not include the effects of the
20 spikes from a couple years ago with regard to
21 discussion of possible sale of PGW, so that's
22 very unusual. We don't want to plan that as
23 recurring regularly.

24 But the sort of normal spikes may occur

1 with contracts that's embedded in our figures.
2 So you're averaging, so to speak. Perhaps some
3 years where expectations more retirements that
4 actually occur, other years be less. The idea is
5 on average we are capturing what the overall
6 behavior will be over the period.

7 Again, back to the second page, we talk
8 about the contribution ranges. The policy is
9 that we -- that PGW contributes the larger of the
10 cost assuming that either there is what we call a
11 20-year open amortization or a 30-year closed
12 amortization period. We are taking -- we are
13 funding what's called the normal cost, which is
14 up at the top of the page. That's costs being
15 earned a year. And there is also funding to pay
16 down the unfunded liability over a period of
17 time.

18 Traditionally, PGW is what they call a
19 20-year open amortization period. Every year we
20 did a new 20-year amortization. We are always 20
21 years away. Last year the decision -- two years
22 ago was to, say, let's continue that but let's
23 lay into that what we call a 30-year closed
24 amortization. Meaning, 30 years would count down

1 over time.

2 What that means in the short run is that
3 for at least the next -- first 10 years, the
4 20-year amortization would be the larger number.
5 That's what the contribution is based on. After
6 about 10 years, the 30-year structure will start
7 to potentially kick up and be a little bit
8 larger. And we'll start to see that take over.

9 The bottom line is, the plan is being
10 funded in a way that will diffuse the liability
11 over time assuming the one thing we, of course,
12 know is not going to be crap, which is that every
13 single assumption we make in this plan will
14 always come true every year. Which is investment
15 return and retirements rate and term rates and so
16 forth. There will be ups and downs. We will see
17 little dips and rises. But more or less, that's
18 what's going on there.

19 So under the funding policy, not just
20 under 32 percent of payroll of this group is
21 what's designated as the contribution for the
22 company.

23 CHAIRMAN SCOTT: PGW, of course, is
24 doing 7.9 million. And they are also on the

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1 annual basis funding 28.6?

2 MR. VINCENTE: They are funding -- the
3 28.6 includes 7.9.

4 CHAIRMAN SCOTT: Okay.

5 MR. VINCENTE: They are doing the 28.6.

6 CHAIRMAN SCOTT: Thank you.

7 MR. VINCENTE: You will see in the
8 bottom of this page, there is a summary of what
9 drove that number as it changed from 2015 to
10 2016. "A" talks us about the discount rate
11 change. That added about 2.6 percent of payroll,
12 about \$2.4 million to the annual cost. We
13 mentioned the investment returns being less than
14 the 7.65 percent assumption. It was actually --
15 so that increased the contribution as well as by
16 about \$800,000.

17 One thing that was also part of the
18 funding policy that was implemented a year ago
19 was that we are going to implement what they call
20 an asset smoothing method. So in the past, we
21 always just used the market value of assets. A
22 lot of volatility in that number. You invest in
23 the market and you're looking at them one
24 particular day. Could be up. Could be down.

1 That could put a lot of volatility in the
2 contribution figures.

3 Decision was made at the time to use
4 what's called a five-year smoothing method. We
5 essentially phase in investing result that
6 deviate from the market return over a five-year
7 period. Essentially, 20 percent per year.

8 So this first year when we had poor
9 experience, we are only recognizing 20 percent of
10 the poor experience which is how we hold down the
11 contribution increase. Next year we will
12 recognize another 20 percent, year after that and
13 so forth. We recognize the full thing over five
14 years. The hope is that over that five-year
15 period, you have good years and bad years. And
16 they essentially offset each other avoiding
17 volatility in the contribution figure.

18 CHAIRMAN SCOTT: Let me read that. It
19 says the investment return for the period ending
20 June 30, '16 was approximately 4.6 million, but
21 should have been 38.2?

22 MR. VINCENTE: Yes.

23 CHAIRMAN SCOTT: Am I interpreting that
24 part right?

1 MR. VINCENTE: Correct. It was a minus
2 4.6, so a negative return.

3 MR. BUTKOVITZ: I got a question for
4 Chris. We are doing better here than in the
5 regular pension fund while making more
6 conservative assumptions. Is there any -- would
7 we do better if we copycatted some of the
8 strategy in the other funds?

9 MR. DiFUSCO: Without getting too far
10 outside my job description for the other pension
11 fund, I will say that I think when you see the
12 asset allocation in September that's being
13 proposed for the large plan, you will see it
14 moving in a direction that is similar to your
15 question. I think you will see -- and based on
16 some of the decisions that you and the other
17 trustees made last month in terms of jettisoning
18 some of the more aggressive fixed income
19 investments and things, yes. I think we are
20 already doing that. I think you will see more of
21 that.

22 MR. BUTKOVITZ: Okay.

23 MR. RUBIN: Very poetical about that.
24 You are learning.

1 MR. DiFUSCO: Thank you. Hopefully,
2 that was all captured perfectly.

3 (Group laughter)

4 MR. VINCENTE: Any other questions on
5 this pension issue?

6 MR. DiFUSCO: How did -- how if at
7 all -- we also, Tom, in the last year staffed
8 PGW, the Commission, we moved to rather than
9 funding, getting a once-a-year deposit from PGW
10 or, excuse me, having them advance most of the
11 benefits, we now get a monthly contribution.

12 How does that impact from a timing
13 perspective now that we get money every month
14 from PGW? You know, we get money and -- does
15 that impact from a cash flow perspective? How
16 does that affect your numbers?

17 MR. VINCENTE: It doesn't really affect
18 our numbers. If you notice on where we talk
19 about the 20-year contribution, we say indicated
20 mid year. We are assuming mid year is when the
21 money comes and basically evenly over the course
22 of the year.

23 MR. DiFUSCO: Okay.

24 MR. RUBIN: Can you explain, C, Tom?

1 MR. VINCENTE: Sure. That's demographic
2 changes. This is what I mentioned demographic
3 variation was relatively small. So what we are
4 seeing here, the big deviations from our
5 assumption were; number one, we have an
6 assumption that salaries will go up by
7 4.5 percent per year over a career. We are
8 looking at one-year period. The increase has
9 gone up for people who are there, both end
10 points, increased about 0.2 percent on average
11 versus 4 and a half percent. That was to the
12 plan's favor. A smaller increase in liability
13 than we otherwise would have expected because
14 payroll went up. This is a payroll-based plan.
15 This is the active liability.

16 There are, as well as number of active
17 folks, 166 of them here, with 30 more years of
18 service who are now eligible to full retirement.
19 They remained active versus they could have
20 retired. So that, we talk about the timing of
21 retirement. So, they didn't retire -- all of
22 them didn't retire. We assume some of them
23 would. That was favorable to the plan. That's
24 favorable to a 0.3 percent of liability.

1 So, those were the two main drivers in
2 terms of we talk about demographic ups and downs.
3 Those are the two things that led to the more
4 positive essentially at 1 percent, want to call
5 it, underperformance of the liability.
6 Liabilities were better than expected by about 1
7 percent. These were the two main things.
8 Payroll going up less, less people retiring and
9 otherwise assumed who can go out to full
10 retirement.

11 MR. RUBIN: So that the bottom line
12 there says the annual contribution was 625,000
13 less.

14 MR. VINCENTE: Right.

15 MR. RUBIN: By PGW to the fund.

16 MR. VINCENTE: Well, no. This \$28.7
17 million would have been 625,000 higher if we had
18 not had these two things occur.

19 MR. RUBIN: Right. They put in 625,000
20 less.

21 MR. VINCENTE: This is prospective.

22 MR. RUBIN: Than what we would have
23 assumed they would have.

24 MR. VINCENTE: Right.

1 MR. RUBIN: Based on the equation here.
2 When that happens in the main fund, the City puts
3 that money in to reduce the liabilities, Chris?
4 Or where they put extra money in to make this
5 closer?

6 How does that -- I guess my question is,
7 should we ask them since they would have been
8 looking at that number anyway, to put that into
9 lower the gap between fully funded.

10 MR. DiFUSCO: I'll have to pull the main
11 funds actuary report, Bill. But offhand, no. I
12 don't think they would -- the City would put that
13 extra money in offhand because I think they would
14 do something similar in that if the liabilities
15 over the 30-year term that we measure in the City
16 fund decrease, then by some corresponding amount
17 the contribution or the expected MMO would drop
18 very slightly, as well.

19 I think. Don't hold me to that till I
20 pull it.

21 MR. RUBIN: They put extra money in,
22 that's just separate and apart from this
23 equation?

24 MR. DiFUSCO: I believe so. I can

1 follow up with you on that offline. I think
2 that's right. I think we do something similar in
3 that regard for both plans.

4 MR. RUBIN: Is it fair to ask PGW to put
5 that money in?

6 MR. DiFUSCO: I mean, it's always fair
7 to ask if the employer has the capacity to add
8 more money. Whether or not they do or want to or
9 legally required are obviously separate
10 questions. But --

11 MR. RUBIN: Was it budgeted in?

12 MR. DiFUSCO: I don't know. You're
13 going to have to ask Dan on that.

14 MR. RUBIN: Was that budgeted in?

15 MR. LEONARD: This was not budgeted in.
16 In fact, it's going to go -- compared to go --
17 expect to increase by approximately \$2.5 million
18 because of the decrease in some earnings from
19 7.65 to 7.3.

20 MR. RUBIN: This would lower the burden
21 that that was going to put on the company.
22 Instead of being that 2.5 million, now it will be
23 625 less.

24 MR. LEONARD: It's not 625 less.

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1 It's -- we are still contributing \$2.5 million
2 extra. We would have contributed to \$3.1 million
3 extra had the liability not --

4 MR. RUBIN: Okay.

5 CHAIRMAN SCOTT: I think I am missing
6 something, so you guys can explain it to me.
7 Remember I'm new. I'm still focusing on, B, I
8 guess under comparative summary.

9 MR. VINCENTE: Right.

10 CHAIRMAN SCOTT: We had a negative
11 return for a year; is that correct?

12 MR. VINCENTE: Yes.

13 CHAIRMAN SCOTT: So, am I looking at the
14 wrong fund? Because I'm looking at one year.
15 All these things are positive.

16 MR. AMMATURO: That's August.

17 MR. DiFUSCO: They are measured as of
18 July.

19 MR. VINCENTE: June 30.

20 MR. DiFUSCO: Excuse me. Thank you. As
21 of June 30. I don't have it in front of me, but
22 as of June 30, the numbers --

23 MR. GOLDSMITH: Was slightly up, I
24 think.

1 MR. DiFUSCO: Slightly up over a year.

2 CHAIRMAN SCOTT: For the year we had a
3 negative return. Is that --

4 MR. DiFUSCO: Well, we had a negative
5 return I think in terms of how Tom is defining it
6 actuarially, correct? Because the return was
7 actually, as I recall, slightly --

8 MR. GOLDSMITH: I think it was slightly
9 on the down side.

10 MR. VINCENTE: If you can turn to page 6
11 of the report, the numbers are on the inner
12 left-hand corner at the bottom. I know they are
13 a little hard to see there. If you look at page
14 6, it says what we put together for the fund.

15 So we have as of July 1, '15, we are
16 \$510 million. You will see the receipts we have
17 there, employer contribution and employees
18 contribution. And then the disbursements coming
19 down to the \$483 million we had in July 2016.

20 So, this is a good time. We do gather this
21 information from a number of sources, so it's
22 possible there could be some disconnect. It's a
23 good time to verify that's right or wrong.

24 From our standpoint, what's important is

1 that we understand the number -- the amount of
2 contributions that were made to the plan. And
3 you will see there the employer contributions
4 total about \$28.6 million; \$600,000 to the
5 employee. The employees in this plan are
6 required to make a contribution to accrue
7 benefits.

8 We see the benefit payouts, \$50.4
9 million. That's for all purposes, returns in
10 employee contribution as well as monthly annuity
11 payments to both retirees and surviving spouses
12 or other beneficiaries. And then administrative
13 expenses. The number we are provided as well for
14 our money that's paid to cover the cost of the
15 plan.

16 That's where our negative \$4.6 million
17 comes from. The 4.8 -- the \$48.3 million is from
18 the Flash Report we received. It's not from an
19 audited statement. Sometimes there's some
20 adjustment to those figures. There is accruals
21 and things like that that could be added or
22 subtracted out. But that's our understanding of
23 the returns of the fund for the period in
24 June 30, 2016.

1 MR. DiFUSCO: So, I guess this is where
2 the confusion -- I just pulled up the June, the
3 Flash Report. So as of June 30, 2016, according
4 to the Flash Report we presented at the last
5 meeting, the returns were up slightly for the
6 year 0.19.

7 MR. VINCENTE: Okay.

8 MR. DiFUSCO: This is showing 0.93, so
9 that would be over 1 percent difference. So I
10 guess I -- how did you arrive at or how did you
11 they arrive at almost 1 percent decrease as
12 opposed to a more flattish number?

13 MR. VINCENTE: What we did was we had
14 the \$510 million from last year.

15 MR. DiFUSCO: Okay.

16 MR. VINCENTE: We got the Flash Report
17 from the Sinking Fund that shows \$493 million.
18 We got the employer/employee contribution as well
19 as the benefit payments and administrative
20 expenses from PGW. The only thing that's left
21 when you have all those figures is to back into
22 the investment, so that's what we do. We back
23 into the investment of the plan.

24 You are looking at the -- so the things

1 that could be different could be the -- you say
2 493 million versus 483 million.

3 MR. DiFUSCO: No. It shows the same --

4 MR. VINCENTE: Still 483.

5 MR. DiFUSCO: It's still 483. Just
6 showing investment return performance over one
7 year at 0.19. This is showing at negative 0.93.

8 MR. VINCENTE: Things that could be
9 different -- I don't know what could be
10 different. We have the benefit pay -- when you
11 look at it, we don't try to break those
12 investment returns down for purposes.

13 MR. DiFUSCO: Right.

14 MR. VINCENTE: We know what adds in and
15 subtractions out are. That only leaves
16 investment return and expense.

17 Is it possible that the administrative
18 expenses are lower than they are? I don't know.
19 We can certainly sit back and talk to you about
20 that.

21 MR. DiFUSCO: Should talk on that.

22 MR. VINCENTE: These are the figures we
23 were provided. We don't audit that. They seem
24 reasonable.

1 MR. DiFUSCO: Okay.

2 MR. VINCENTE: Bottom line from our
3 perspective, with a little bit of a caveat is
4 that the driver is not necessarily what that
5 investment return figure was, so much as what the
6 asset value was at July 1, 2016 the \$483 million.
7 So that number is right. Yes, there could be a
8 little bit of deviation if it turns out that --
9 if we have a number here.

10 Say the benefit payments, there was
11 something included in the benefit payments that
12 shouldn't have been, or something that's being
13 missed there. Say there is an extra million
14 dollars of benefit payment that just wasn't
15 included here for a hypothetical. If that should
16 have been \$51 million, that means the investment
17 return would have been a million dollars better
18 because that million dollars is coming out
19 investment return today. It will have a small
20 effect because we are smoothing the investment
21 return over a five-year period, but it won't have
22 a big affect on these numbers.

23 We should certainly iron out what the
24 differences are there.

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1 CHAIRMAN SCOTT: Do you have that number
2 investment returns going back three, four years?

3 MR. VINCENTE: What the actual return
4 was?

5 CHAIRMAN SCOTT: Yes.

6 MR. VINCENTE: I don't think we have it
7 in this report. I have a cheat sheet here.

8 CHAIRMAN SCOTT: I am trying to figure
9 out what the trend is.

10 MR. VINCENTE: You know, it's been both
11 up and down. I do not have that here. There is
12 definitely been years where -- go ahead.

13 MR. AMMATURO: I have it. 2015 was
14 negative 0.49; 2014 was positive 6.91; 2013 was
15 positive 18.04; 2012, positive 11.7; 2011,
16 negative 0.66.

17 MR. GOLDSMITH: Those are calendar year?

18 MR. AMMATURO: Calendar years.

19 CHAIRMAN SCOTT: Thank you.

20 MR. VINCENTE: I guess back to page 2.
21 Other than resolving the question, did we answer
22 the question you had?

23 CHAIRMAN SCOTT: You did.

24 MR. VINCENTE: Okay. Any other

1 questions on page 2, the summary of the -- just
2 moving ahead if there is no questions, a lot of
3 the intermediate pages are details of the
4 calculations. I wasn't going to go through that
5 unless people really want me to. We want to flip
6 ahead to page 12.

7 Page 12 shows the expected future cash
8 payouts for the plan. We are expecting, based on
9 our assumed patterns for retirement in the future
10 that in the coming year, the year beginning July
11 '16 through June 30, '17, we had about
12 \$52 million in benefits including beneficiaries
13 and retirees. And you will see how that number
14 evolves over the ten-year projected period if all
15 our assumptions are met. Topping out at about
16 \$62 million in 2025.

17 That just gives you a sense for what the
18 cash demands and the plan will be in the future.
19 And you saw the cash contribution levels were
20 expected to be in the \$30 million range. So,
21 there is more going out of the plan than there is
22 going in, in terms of cash flow. So, that means
23 that the extra amounts coming out of the
24 benefit -- out of investment returns and coming

1 out of the principal, which you expect of plans
2 that had the demographic structure of this plan
3 is where there is many more retirees than there
4 are active employees. The plan is
5 demographically in a place where we are expected
6 more of a draw down in the plan because there is
7 so many more retirees than there are active
8 employees.

9 If we turn to page 13, page 13 gives you
10 some history of the funded status of the plan.
11 So looking at the chart, the red bar show the
12 liabilities. So, we calculated the current value
13 of future payouts. The blue line is the market
14 value of plan assets. And then the black number
15 tells you what percentage funded that is. This
16 goes back to 2008.

17 So before the market correction in 2008,
18 we are about 87 percent funded. Like many plans,
19 the following year, the plan was much less well
20 funded, began climbing. This year we go from
21 72 percent last year down to 65 percent this
22 year. The big driver, again, remember here is
23 that we changed the expected return at the
24 expected discount factor of 7.65 to 7.30. That

1 boosted the liability, which hurts our funded
2 ratio. And we had the investment performance
3 which is less than the 7.65 percent return.
4 Lowered the assets compared to what you would
5 expect them to be. That causes that retreat from
6 72 percent to 66 percent funded in the plan. So
7 something we did by assuming a more conservative
8 posture. Some of it because of the way the
9 market performed. The top of the page are the
10 numbers that go with the graph.

11 If we want to turn ahead to the page 16,
12 page 16 gives you a ten-year look forward on cash
13 contributions as well as how we expect the funded
14 ration to evolve over time. So we expect the
15 con -- the fund we are funding over a
16 20-year/30-year period. You will see in the
17 chart at the top, the funded ratio does increase
18 over time, though, very gradually.

19 You will see it goes down over several
20 years from 70 percent. It goes down in the
21 69 percent range. That's because we are phasing
22 in those investment losses from this past year
23 where we didn't hit the 7.65 percent. I
24 mentioned it's a five-year phase in. As we phase

1 in, this chart assumes we are only going to get
2 7.3 every year in the future. There is no
3 offsetting actuarial gains. That is why we see a
4 decrease in the funded ratio because it was the
5 ratio based on smooth assets. As we phase in
6 those lower -- that return from the prior year,
7 it brings the fund ratio down a little bit, and
8 then we start to go back up. So very gradual,
9 which is what you expect to see with what amounts
10 to a 30-year payout on the plan. It's not going
11 to be a sharp increase in funded ratios.

12 If everything meets our assumption, we
13 will have a very gradual increase. And will over
14 time gain some momentum, but it will have been
15 very gradual in the beginning.

16 MR. DiFUSCO: And, Tom, the reason why
17 the funded ratio date is 7/1/2016 on page 16
18 differs from what's on page 13 is because on page
19 16 you are using the smooth calculation?

20 MR. VINCENTE: Correct. Yes.

21 MR. DiFUSCO: 13 is under the old
22 system?

23 MR. VINCENTE: Yeah.

24 MR. DiFUSCO: Okay. Thank you.

1 MR. VINCENTE: That is the projected
2 cash contribution. Starting back on page 19, we
3 have a breakdown on a lot of the demographic
4 information, so by the age and service and
5 payroll levels. So we had some folks asking
6 about, you know, it's very interesting. We have
7 got quite a number people for -- these are page
8 19, I should say, the number of retirees.

9 So, we have 138 retirees or their
10 beneficiaries who are over 90 years old. There
11 is a death audit that's done every year by both
12 of the folks writing the checks, paying the
13 beneficiaries as well as ourselves. These, at
14 least, don't show up as a death audit as
15 deceased. These are legitimate individuals
16 90-plus years old receiving pensions.

17 Going to the next page 20 is a similar
18 age service chart for physically active
19 employees. When you look at this, you will see
20 from a group this size from our perspective, we
21 actually have very few folks over the age of 65.
22 So, the ages are the horizontal axis. We only
23 have 16 individuals who are aged 65 or older. We
24 talk about people retiring and when they are

1 retiring. This group tends to go out "on time."
2 They don't stay to a very old age, which you
3 might see in some other professions or groups
4 where they are a lot more 70 year olds. In this
5 case, is a relatively small number.

6 MR. RUBIN: What's the number underneath
7 the number of participants?

8 MR. VINCENTE: That's the average
9 payroll for that particular group.

10 MR. RUBIN: They're payroll, not the --

11 MR. VINCENTE: Right. Where you see
12 it -- see somebody that is eight people in the
13 \$45,000 figure under that, that means eight
14 people average pay is \$45,000. Not that many at
15 a very high service. Not that many at older age.
16 You can see that graphically on page 21, the
17 active head count by service.

18 You will see that the biggest service
19 component, the 5 to 10 years of service; 25 to 30
20 the next year. The next biggest. Not that many
21 after that. Bit of a dip in the middle or
22 reflects hiring patterns and turnover patterns.
23 That is the main results here.

24 Starting back on page 23, we have all

1 our assumptions and methodologies. We are using
2 an up-to-date mortality table. The most
3 up-to-date we have from society of actuaries this
4 group. The size of it is incredible enough to
5 develop its own mortality or longevity
6 statistics.

7 We have a set of table from Society of
8 Actuaries. We use a turnover in the retirement
9 table that is based on the group here. We do
10 update that every three to four years. It is
11 updated just a year or so ago. No update right
12 now. With our demographic losses and gains being
13 relatively small. It seems to be borne out at
14 least in the first couple years.

15 I will stop there. That is what we had
16 presented.

17 CHAIRMAN SCOTT: Thank you. That was
18 very interesting.

19 The next item is the Investment Policy
20 Statement Asset Allocation Review.

21 MR. GOLDSMITH: Sure. This was
22 something, if you recall, we discussed at the
23 last three meetings or last two meetings and then
24 today, as well. So, I think we will just go back

1 and kind of cover what's been discussed and the
2 summary level, and set some next steps. If we
3 turn to the asset allocation tab, I think I will
4 begin with the actual asset allocation which is
5 towards the back of this section. You see the
6 colored sheet dividers. After the last one is
7 where the asset allocation analysis can be found.

8 Mark has it.

9 MR. AMMATURO: It's called Philadelphia
10 Gas Works Sinking Fund Commission Asset
11 Allocation Analysis. It's that same section but
12 further back.

13 MR. GOLDSMITH: You will see the teal
14 sheet dividers. You are in the middle of it now.

15 MR. AMMATURO: There it is.

16 CHAIRMAN SCOTT: Thank you.

17 MR. GOLDSMITH: And what this was is
18 it's a projection, a forward-looking projection
19 of expected return and risk of the current
20 portfolio and several proposed alternative asset
21 allocations. This was something that we wanted
22 to do once we began our consulting relationship
23 with the Sinking Fund. We wanted to get in and
24 look at current allocation and maybe some

1 alternatives and where that would take the
2 portfolio.

3 So again, just to refresh, it starts off
4 depicting our capital markets assumption. This
5 is our expected return and volatility risk for
6 various asset classes both over the intermediate
7 term next five years and the long term, which is
8 30 years in the future and beyond.

9 CHAIRMAN SCOTT: Where are you now.

10 MR. GOLDSMITH: I am on page 2. Page 1
11 depicts those graphically. Page 2 you can see
12 the numbers. Five years in the left, 30-plus on
13 the right, and then the expected return, expected
14 volatility for each of those asset classes.

15 These are the input that go into our
16 asset allocation analysis. Flipping ahead now to
17 page 4, you can see across the page are the
18 various portfolio alternatives. The farthest
19 left is the current targets for the Sinking Fund.
20 And the four to the right were alternatives that
21 we both brought to the table to discuss. You can
22 see the weights of each of the asset classes from
23 those portfolios. The equity component, fixed
24 income, and then alternatives which are not in

1 the portfolio today. We do not agree to add
2 those back at the May meeting when this was
3 initially discussed, but the three portfolios to
4 the far right: PFMAM 60/40, 65/35 and 70/30.
5 You will notice that those do have some
6 alternative allocation to private real estate and
7 private equity. We wanted to model that out
8 potentially for the future and see what included
9 in those illiquid alternatives could do for the
10 portfolio.

11 Below that you see the output of the
12 simulation. Expected return and standard
13 deviation. That's the projected return for each
14 total portfolio and the expected volatility of
15 those portfolios. I think something -- and then
16 below that, the probability of achieving various
17 discount rates. Initially when this was done, it
18 had not been agreed to lower the target rate of
19 return from 7.65 to 7.3. That's all been done
20 now. And you can see the chances of achieving
21 those rates of return over five years for the
22 intermediate assumption and 30 years for the long
23 term.

24 I think one thing that's very obvious

1 from looking at this is that we expect returns to
2 be challenged over the intermediate term. I
3 think with fixed -- with yields on fixed income
4 very low and expected to rise, that will
5 challenge bond prices. While the markets been
6 cooperating this summer, its valuations are very
7 high. As we discussed earlier, there are some
8 headwinds in the form of geopolitical risks. And
9 we discussed the Brexit decision last meeting, as
10 well, that posed some headwinds to global
11 equities. And so, that's where we think are the
12 return expectations meted over the near term.

13 So, this was originally presented in
14 May. And what was, you know, agreed upon was to
15 move from the current targets to that second
16 column 65/35 no alts. We weren't quite ready to
17 dive into the private real estate or private
18 equity. But what was agreed upon was
19 diversification of the fixed income bucket.

20 I think you can look at, you know, the
21 first column to the second column within that
22 fixed income section. You will notice the
23 introduction of some other subasset classes,
24 investment grade corporate credit, emerging

1 markets debt, high yield and floating bank loans
2 were also modeled.

3 What we agreed upon, I believe was
4 agreed upon in May, was to include investment
5 grade credit, emerging market debt and high yield
6 in the portfolio. And to issue RFPs for those
7 asset classes, some asset classes.

8 Another difference between what is
9 showing in the current portfolio, in that 65/35,
10 is a shift somewhat away from domestic equity.
11 From 50 percent domestic equity to 42 percent.
12 And I think that's a reflection of where the
13 domestic equities portion of global market cap.
14 It's closer in line with what domestic equity
15 represents within the entire global equity
16 universe. Commensurately, increase in emerging
17 markets equity target, as well.

18 So that PFMAM 65/35 is where we agreed
19 to go with the exception of the bank loan. I
20 believe that piece was not agreed upon. And so,
21 if there are any questions, we can answer --
22 address those now or then go on to the next step,
23 which was the investment policy statement.

24 So obviously to diversify the fixed

1 income and eventually to perhaps to add some alts
2 down the road, the investment policy statement
3 would require some updates. It could have been
4 just simply allowing for foreign domicile fixed
5 income, allowing for below investment grade fixed
6 income to allow for some of the credit and high
7 yield options. And we could have added that to
8 the existing document.

9 But in looking at what has been
10 governing, was prepare by Gallagher in connection
11 with Sinking Fund, I think we wanted to take this
12 opportunity to make some more broad wholistic
13 changes to the document. Get in the framework, I
14 think, we would recommend for this portfolio
15 going forward for the long run. And so, that was
16 discussed at the last meeting in July. We had
17 brought in the redline IPS and discussed -- we
18 went through each change at a close level, but
19 also we discussed the high level themes. So, I
20 could introduce those today of the general
21 thematic changes.

22 I think the first one was a
23 simplification of the asset allocation targets,
24 so removal of dedicated small cap and large cap

1 equity targets. What that does is it -- at the
2 same time also broadening the allowable ranges.
3 If you want to take a look at this, you can
4 actually flip through to page 3 of the redline
5 investment policy statement. And you can see
6 about halfway down the page, it's highlighted in
7 grey. But this was the new proposed asset
8 allocation target. Down below it is lined out.
9 You can see there's dedicated small cap and large
10 cap targets. The ranges, the allowable ranges
11 are also smaller.

12 And so, by going to a total domestic
13 equity and a broader range for the portfolio
14 allocations, this makes it a more usable
15 framework for taxable asset allocation. I think
16 this was discussed, as well. We wanted to lower
17 increases international equities, for example. A
18 broader range allows that to be done. I'm not
19 saying we would do it, but it allows for that to
20 take place without being noncompliant.

21 I think if you look down below to what's
22 crossed out, you can see the ranges for
23 international equity. It's currently a
24 15 percent target with a minimum allocation of 12

1 and a maximum allocation of 18. That's a pretty
2 small range of just 6 percent you can work with
3 there. And so, you know, it's -- that was one of
4 our broad thematic changes. In minor change that
5 accompanies this, would be a change of the
6 benchmark weightings to align with the new -- the
7 new targets.

8 Another change that -- another broad
9 thematic changes to this document is a shift from
10 an inclusionary framework of what was allowed in
11 the portfolio to exclusionary framework. So, the
12 previous documents said these investments are
13 allowed in the portfolio. And a lot of it is you
14 can look at page 4 and page 5. It's all crossed
15 out now. But I think by both -- further on in
16 the document, actually, there is a section that
17 lists excluded investments. So, it gets a little
18 confusing when you have both included and
19 excluded and there are a range of investments
20 that aren't mentioned at all. Where do those
21 fall?

22 I think the approach we took to the
23 edited document is to go to an exclusionary
24 framework explicitly listing what you do not want

1 in a portfolio. And so, that's what changed.

2 And the last of the thematic changes
3 pertains to diversification requirements. These
4 are things like what percent of the portfolio can
5 be in one individual security, one individual
6 sector, one individual country for international
7 equity. And currently, those requirements apply
8 at the individual manager level. So, a manager
9 cannot have more than X percent in high yield or,
10 in this case, no below investment grade
11 securities. In our edited document, we proposed
12 changing these restrictions to the total
13 portfolio level. The total portfolio must be --
14 if I can look for where this is. I believe it's
15 on page 7 of the edited document.

16 So, you can see what's been crossed out
17 down below -- halfway down the page. No more
18 than the greater of 20 percent or three times the
19 applicable benchmark index weighting in one
20 market sector. That's essentially limiting the
21 amount you can have in one sector, like, consumer
22 discretionary, utilities, telecom, and then
23 applied to each manager. We wanted to have that
24 go to the total portfolio level. That's what you

1 see up above. No more than greater of 5 percent
2 or the weighting in the relative index maybe in
3 one corporation. No more than 40 percent in any
4 one sector. And by moving that to the total
5 portfolio level, it allows for the inclusion of
6 potentially concentrated investment manager, that
7 maybe you get concentrated in a given geography
8 or they might have overweights to certain sectors
9 that go beyond the 20 percent limit as previously
10 -- as was previously set.

11 It doesn't mean that those managers will
12 be put in the program, in the portfolio, but it
13 allows for those types of funds if we feel that
14 concentrated manager could have value portfolio.
15 Another example is some concentrated manager, as
16 I mentioned, would be dedicated high yield funds
17 within fixed income. Currently, below investment
18 grade is prohibited. That's one element. Even
19 if, you know, we wanted to have concentrated high
20 yield funds, you know, I think that by moving the
21 restriction to the total portfolio, just a lot
22 broader portfolio management.

23 So, those are the three main themes.
24 And what follows, I think, when you get beyond

1 page 7, you get into the -- we have the
2 exclusionary what we don't want in the portfolio.
3 And then beyond that, I think at page 13, section
4 5 the objective section, I mentioned that slight
5 changes were made to that to the total portfolio
6 benchmark. And then we also felt that this
7 document was overly not necessarily restrictive,
8 but just maybe overstepping it's bound by setting
9 benchmarks for every individual subasset class.

10 When a new manager is hired, there are
11 investment manager agreements that are set in
12 place. We feel that those investment manager
13 agreements are more appropriate to set individual
14 manager performance guidelines and benchmarks.
15 That's just the four themes. I wanted to lump
16 that in with the first one.

17 So, this is where we are. I know we
18 received a couple of questions after the
19 following meeting. I think we addressed some of
20 those offline via phone calls or various meetings
21 in the last two months. I think the logical next
22 step would be to get some comments back from the
23 Commission or from staff either in the form of
24 you can have an email or redline exchange or an

1 executive session to sit through and, you know,
2 really line by line hammer out what this document
3 should look like. And I would expect some
4 feedback from you. These are our thoughts about
5 what should be excluded from this portfolio, but
6 I think we would like to hear your comments back.
7 I think we have a framework potentially for
8 private investments to be included. You can do
9 that now rather than amend this two years down
10 the road again. Maybe that's not in line with
11 what the Commission is thinking or staff.

12 MR. DiFUSCO: In terms of next steps,
13 you would like staff to perhaps speak to
14 Commissioners offline and then kind of gather
15 comments and feedback that we can then send back
16 to you, and then have discussions, you know,
17 one-on-one or whatever as necessary?

18 MR. GOLDSMITH: Uh-huh. Again, it can
19 be some broad comments of the themes. Or if you
20 are agreeance with the general structure, we can
21 really get down to the nitty-gritty what is and
22 isn't allowed in the portfolio.

23 MR. DiFUSCO: In terms of the timeline,
24 you would like to have this back on the November

1 Agenda to incorporate all those comments and so
2 forth and hopefully --

3 MR. GOLDSMITH: Yeah.

4 MR. DiFUSCO: Hopefully, then be able to
5 move forward.

6 MR. GOLDSMITH: If we can reach some
7 kind of consensus offline, that would be ideal.
8 That would allow for the selection of some
9 managers that are out for RFP and then their
10 implementation.

11 MR. MAZZA: So, an executive session end
12 of October you think would be appropriate?

13 MR. DiFUSCO: I will defer to the law
14 department. If we are talking an executive
15 session in the legal sense, I don't know that I
16 think that's legit for an executive session. If
17 we need an executive session in terms of staff
18 talking to PFM or talking to Commissioners
19 individually to get their feedback, if we mean
20 the non-legal sense, I think that's okay.

21 I will defer to Ellen and Adam. I don't
22 believe reviewing an IPS as a group qualified for
23 a legal executive.

24 MS. BERKOWITZ: No, I would not think

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1 so.

2 MR. DiFUSCO: We would do, you know,
3 series of, you know, individual calls or meetings
4 to incorporate feedback which we then present to
5 the full group in November. Is that --

6 MR. GOLDSMITH: That was what I was
7 inferring.

8 MR. DiFUSCO: I just want to make sure.
9 When you use that term, I don't know what you
10 meant.

11 MR. GOLDSMITH: I did not mean anything
12 in a legal sense.

13 MR. DiFUSCO: Wasn't sure.

14 MR. GOLDSMITH: Is that -- is the
15 Commission okay with doing that in terms of calls
16 or discussion getting feedback, bringing you back
17 in November?

18 CHAIRMAN SCOTT: Yes.

19 MR. DiFUSCO: Okay.

20 CHAIRMAN SCOTT: Thank you very much.
21 New Business Discussion.

22 MR. DiFUSCO: Thanks, Don.

23 I think most of the new business was
24 covered in terms of the timeline. I think Marc

1 and Alex mentioned there is a bunch of RFPs
2 either received submissions that are closed or
3 outstanding. I would envision that we would
4 start to bring candidates to the Commission in
5 various asset classes depending on where we are
6 with the asset allocation as soon as November if
7 we feel that we have a good consensus and good
8 candidates and are in a position to move forward.
9 If not, we would shoot for the January meeting.
10 That was the main item.

11 And then the second item I just wanted
12 to mention was that PGW provided -- you will see
13 that's the last two tabs in your book -- the
14 payroll summaries and the benefit summaries that
15 have been requested. Obviously, if any questions
16 on any of that, you know, by all means follow up
17 with Matt, myself or Dan at PGW.

18 Those are the only two items I have.

19 MR. MAZZA: Can we get one out from you
20 guys on how they might perform in any ways that
21 going to either hurdle or beneficial to our plan?

22 MR. GOLDSMITH: We are in the government
23 or our portfolio was in the government money
24 market fund. Previously, the portfolio was in

1 the Heritage money market fund. And the changes
2 that were discussed, I think it goes back to
3 2014. And they will implemented starting
4 October, I believe, is when they will take place.

5 But it's floating NAVs to money market
6 funds. Money market funds historically is dollar
7 in and dollar out. They are used for cash
8 management. Some of them may hold, I guess, some
9 slightly riskier securities. They have higher
10 yields. And for those funds, there would be a
11 change in governance going to a floating NAV to
12 allow for the movement attributable to any risk
13 in the portfolios as a result and also various
14 redemption gates.

15 So if there was ever stress in the
16 market, there potentially could be a lot of
17 people looking to withdraw from the money market
18 funds. There could be gates set up limiting
19 liquidity, which is not ideal when being used as
20 a cash management vehicle and benefit payments
21 are coming out.

22 In addition, Wells Fargo was not
23 allowing for those non-government money market
24 funds or floating rate NAV funds we use to sweep

1 vehicles. This really was no longer to be an
2 option for the portfolio. We looked at what the
3 options were. There were some funds, including
4 some bank deposit funds backed by commercial
5 deposits at Wells Fargo and, you know, the broad
6 universe of government money market funds which
7 are traditional treasury securities without the
8 risk of the other floating NAV funds.

9 I think the -- comparing the yields for
10 the bank deposit fund and the government fund,
11 they were very, very similar. Actually, I
12 believe at the time we looked at it, the
13 government fund had higher yield than the bank
14 deposit fund. Which is odd considering that
15 while you expect the deposit to Wells Fargo to be
16 very secure, there is a counter-party risk
17 inherent in having deposits for Wells Fargo.
18 There is some nominal level, additional level of
19 risk in the bank deposit fund. But as I
20 mentioned, their yields were lower at the time of
21 the government.

22 MR. MAZZA: The fees were cheaper, I
23 believe, as well.

24 MR. GOLDSMITH: The fees are also less

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1 expensive for the government fund. There is less
2 being done typically again. So, we felt that the
3 additional risk was not necessary. The return
4 was -- for the yields were appropriate, and the
5 fees are appropriate, too. So it's -- we're in
6 that -- the portfolio was in that vehicle and
7 prepared for the changes to take effect.

8 MR. DiFUSCO: Thank you.

9 CHAIRMAN SCOTT: Any other comments
10 before we adjourn?

11 MR. RUBIN: I just want to say that
12 the -- I think we had a much clearer picture this
13 year with the actuary report staff and Dan and
14 Joe from PGW giving us background information on
15 the retirees who are leaving. And I think we
16 have a better feel for what we're trying to do to
17 make sure the plan is solid going forward. I
18 want to say thank you to the work that was done
19 behind the scenes to make sure we have a better
20 understanding.

21 CHAIRMAN SCOTT: Thank you.

22 This meeting is hereby adjourned. Thank
23 you very much.

24 (Sinking Fund Meeting adjourns at 12:11 p.m.)

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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 in the foregoing matter, and that this is a correct transcript of the same.

ANGELA M. KING, RPR
Court Reporter - Notary Public

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