
JACKSONVILLE POLICE AND FIRE PENSION FUND
FINANCIAL INVESTMENT AND ADVISORY COMMITTEE
MEETING SUMMARY – JANUARY 11, 2019 – 3:30PM

FIAC

Eric "Brian" Smith Jr., Chair
Rob Kowkabany
Rodney Van Pelt

STAFF

Timothy H. Johnson, Executive Director – Plan Administrator
Steve Lundy, Assistant Plan Administrator
Kevin Grant, Finance Manager
Pedro Herrera, Fund Counsel – via Webex
Lawsikia Hodges, Office of General Counsel – via Webex
David Lindberg, Wilshire Associates – via Webex
Alex Ford, Wilshire Associates – via Webex
Brian White, Wilshire Associates – via Webex
Bob Parise, Northern Trust – via Webex
Pete Strong, Actuary – via Webex

GUESTS

Randall Barnes, Fund Treasurer

EXCUSED

Craig Lewis Sr., Secretary

Meeting Convened:

3:34PM

Meeting Adjourned:

5:25PM

NOTICE: Any person requiring a special accommodation to participate in the meeting because of disability shall contact Steve Lundy, Assistant Plan Administrator at (904) 255-7373, at least five business days in advance of the meeting to make appropriate arrangements. If any person decides to appeal any decision made with respect to any matter considered at this public meeting such person will need a record of proceedings, and for such purpose such person may need to ensure that a verbatim record of the proceedings is made at their own expense and that such record includes the testimony and evidence on which the appeal is based. The public meeting may be continued to a date, time, and place to be specified on the record at the meeting. Additional items may be added / changed prior to meeting.

I. PUBLIC SPEAKING PERIOD

None.

III. MEETING SUMMARIES TO BE APPROVED

Motion to approve: VAN PELT; Second: KOWKABANY; APPROVED UNANIMOUSLY.

1. **FIAC Meeting** – December 14, 2018

II. ELECTION OF OFFICERS

1. Chair

Motion to nominate Brian Smith as Chair for 2019: VAN PELT; Second: KOWKABANY; APPROVED UNANIMOUSLY.

Brian Smith said he is willing to serve another year as Chair, but would open the floor for any other nominations (there were none).

Rodney Van Pelt made a motion to nominate Brian Smith as Chair of the FIAC for 2019. Seconded by Rob Kowkabany. The vote passed unanimously.

2. Secretary

Motion to nominate Craig Lewis as Secretary for 2019: KOWKABANY; Second: VAN PELT; APPROVED UNANIMOUSLY.

Rob Kowkabany asked if Craig Lewis has indicated he would like to continue to serve as the Secretary of the FIAC.

Brian Smith said he has no indication, as Craig Lewis is not present at the meeting.

Timothy Johnson said he emailed Craig Lewis and asked if he wishes to continue serving as Secretary, but did not receive a word indicating he did not wish to continue.

Rob Kowkabany made a motion to nominate Craig Lewis as Secretary of the FIAC for 2019. Seconded by Rodney Van Pelt. The vote passed unanimously.

IV. INVESTMENT CONSULTANT REPORTS

David Lindberg

David Lindberg informed the FIAC that he would be presenting from the updated slides contained in the handout. Alex Ford and Brian White of Wilshire would also be on the line to answer any questions if needed.

1. Allocation of City Contribution

Motion to accept Wilshire's recommendation and the Board of Trustees' action: KOWKABANY; Second: VAN PELT; APPROVED UNANIMOUSLY.

David Lindberg began presenting his handout 'Capital Markets Review, Performance Update, and Payroll Contribution'. He made the following points:

- Wilshire has been learning more about how the City and PFPF's cash flows work as they relate to the City's advance contribution.
- Wilshire feels that the current method of cash flows is 'lumpy' and is difficult to manage considering market volatility.

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- *Wilshire is happy to work with the City and PFPF to smooth out these cash flows, should the City and PFPF wish to revise their current practice.*
- *The Payroll Contribution recommendation phases in the City's \$116 million contribution over 3 months, and leaves \$8 million in cash to meet the Fund's liquidity needs.*
- *The Board of Trustees approved the Payroll Contribution recommendation in January, and the first tranch of investing the \$116 million is complete.*

Brian Smith said he doesn't understand why the Fund should go into indexes in this climate of volatility. He said he thinks active managers would welcome cash and take advantage of buying opportunities. Active should have the potential to outperform passive.

David Lindberg said there is certainly potential, but the challenge exists in the short term – it is hard to know what is driving market returns currently and when active management will outperform and when it will not.

Brian Smith asked what costs are associated with transferring funds in and out of actively managed accounts versus passive accounts.

David Lindberg said costs are much higher in actively managed accounts. Index fund costs are much cheaper as they are spread across the whole fund, not individual accounts.

Rob Kowkabany made a motion to accept Wilshire's recommendation and the Board of Trustees' action. Seconded by Rodney Van Pelt. The vote passed unanimously.

2. Market Update

David Lindberg discussed the Capital Markets Review portion of the handout, noting performance across all asset allocation classes. He made the following highlights:

- *This was a rough 4th quarter.*
- *At September end, the US equity market was up 10.5% - it was down 14.29% for the 4th quarter. The Year-To-Date return is -5.27%.*
- *Overall performance improved in January – through Wednesday of this week, US equities were up 3.6% and non-US equities were up 3.8%.*
- *Bonds are slightly positive.*
- *The Fund is long term. These negative numbers mean volatility is returning to the markets after a long absence. It is good to return to normal markets.*

David Lindberg noted that Wilshire is still in the process of getting access to the Fund's performance data from Northern Trust.

Rodney Van Pelt asked if Wilshire would have access to the Fund's data in time to provide normal reporting for February's FIAC meeting.

David Lindberg said Northern Trust has most likely not yet finalized December's data. Once the data is in Wilshire's system, then all the reports will run – they should be ready in time for February's FIAC meeting.

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David Lindberg said much of the volatility in the marketplace has been driven by automatic electronic selling – in US markets and in non-US markets.

Brian Smith asked if Wilshire has a market outlook for 2019.

David Lindberg said Wilshire does not have outlooks on a year-long period because it is too short term. Wilshire develops outlooks for 10-year periods and longer.

David Lindberg discussed the US economic climate, noting that earnings are strong, inflation is decreasing, employment is strong, and the Fed is backing off quantitative easing.

Rodney Van Pelt asked David Lindberg if Wilshire has reviewed any of the Fund's money managers, and if Wilshire recommends any changes.

David Lindberg said there are no recommendations for change yet. Wilshire has taken all of the Fund's money managers and put them into the Wilshire research pipeline. As is the practice for any plan, Wilshire reviews its research to see if it has already reviewed any of the Fund's managers previously. If Wilshire finds a manager that has not yet been reviewed and researched, they will enter the research pipeline.

David Lindberg said most of the Fund's managers are known by Wilshire to be at least average or above average. Some managers have not been reviewed by Wilshire recently, and those are in process. If anything comes out of that process that results in a recommendation for termination, Wilshire will inform the FIAC. The whole timeline to research a money manager takes about 2 months.

V. EXECUTIVE DIRECTOR'S REPORT

Timothy Johnson

1. New FIAC Member Recruitment – Update

Timothy Johnson updated the FIAC on the search for a candidate to fill Tracey Devine's absence on the committee. He has talked with Beth McCague and Joey Greive to discuss and ask for any suggestions for candidates. So far, no suggestions have been received.

Timothy Johnson said the path to identify a candidate will go through the FIAC. The FIAC will vote, then the Board of Trustees will approve. Then they will be escorted through the City Council approval process.

VI. OLD BUSINESS

1. Directed Brokerage – Handout

Bob Parise

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Timothy Johnson said that the FIAC and Board of Trustees have been talking about 'emerging' managers and brokers for months. When Northern Trust visited in August, diversity goals were briefly discussed. Today, Bob Parise is on the phone to discuss Northern Trust's minority broker program which may help the FIAC and Board of Trustees reach their goals.

Bob Parise began his presentation and made the following points:

- *Northern Trust has had a formal program of leveraging and partnering with minority firms since 2007.*
- *Currently about 12 plan sponsors that place upon their managers a directed brokerage requirement.*
- *Page 4: Northern Trust has a roster of 8 firms it uses for diverse trading services.*
- *Northern Trust holds these minority brokerage firms to the same standards.*
- *Northern Trust's fiduciary standard is to provide the best execution and cost.*
- *These 8 firms were gathered through an RFI and through advertisements across numerous publications. Firms were visited and made presentations before being chosen.*

Timothy Johnson asked if any of these firms are located in Florida.

Bob Parise said none are headquartered in Florida, but some may have local offices.

Brian Smith asked if the Fund is using any of these brokers through its money invested in its Northern Trust – managed accounts.

Bob Parise said he believes so, specifically with the firm Loop Capital Markets on page 4 of the handout. He continued his presentation and made the following points:

- *Northern Trust is on the leading edge of utilizing minority brokers for asset management.*
- *All of Northern Trust's funds have a 10% minority brokerage utilization target.*
- *The Fund's S&P 500 index fund, Aggregate Bond Index Fund, and its EAFE index fund all utilize minority brokers at a level of at least 10%.*

Rodney Van Pelt asked if Northern Trust can measure the success of its diverse brokerage policy since implemented in 2007.

Bob Parise said he doesn't have data to 2007, but in 2018, Northern Trust paid total commissions of approximately \$840,000 to minority brokers, which was about \$740,000 more than was required by contract or policy. This clearly illustrates that Northern Trust, as an organization implements its diversity initiatives outside of what its clients say.

Timothy Johnson and the FIAC discussed the current progress of the Fund's Statement of Investment Policy, noting that it has not yet been approved.

Brian Smith said he feels that the process of approving the Fund's Statement of Investment Policy has been going on for a while. The FIAC sent it to the Board of Trustees, and they have not acted. He said, "In my mind, it's solved. We said to keep the original language. The Board didn't accept or reject."

Timothy Johnson said the Board of Trustees effectively rejected it by not calling a vote. He wants to get the emerging manager and brokerage sections in place first.

Brian Smith asked to schedule a meeting with himself, Chris Brown and Timothy Johnson to hammer out the details of the Statement of Investment Policy. He said, "Let's talk and figure out how to proceed."

VII. ACTUARY REPORT

Pete Strong

1. **Actuarial Valuation** – Handout

Motion to recommend approval of the Actuarial Valuation to the Board of Trustees, emphasizing that the Board of Trustees request the City to consider an additional contribution exceeding the minimally required amount: VAN PELT; Second: KOWKABANY; APPROVED UNANIMOUSLY.

Pete Strong presented his Actuarial Valuation Report as of October 1, 2018 handout. He made the following highlights:

- The contribution requirement is up a bit from \$135 million to \$143 million. The primary reason is payroll increases.
- The bulk of the increase in employer normal cost is driven by payroll.
- The 'needle wasn't moved very much' due to the return on assets – the smoothing method calculated a return of 7.2% (7.99% actual). This was not much of a gain in terms of reducing the contribution.
- Surtax experience for the year was higher than assumed. The surtax increased by over 6% for the year, as opposed to the assumed rate of 4.25%.
- The PFPF's share of the future surtax proceeds fell from 62.5% to 60.9% due to a number of factors, including the City's other funds reducing their assumed rate of return, which increased their total unfunded liability.

Rodney Van Pelt asked if any assumptions other than the assumed return on assets are different this year.

Pete Strong said the return assumption is different – it changed from market value to smoothing. Other than that, the other assumptions are the same – salary growth, rates of disability, mortality, etc...

Rodney Van Pelt asked if the surtax growth rate assumption is the same across all of the City's plans.

Pete Strong said yes, it is 4.25% over all three plans.

Brian Smith asked about the difference in the actual and assumed surtax growth rate, and how it affects the contribution even through we are not yet receiving the funds from the surtax.

Pete Strong said every year, the 'starting point' is updated with the actual surtax return, and forecast forward with the assumed growth rate. Last year, the surtax was expected to grow by 4.25%, but it grew at a higher rate of more than 6%. Next year, we assume it will grow by 4.25%, not 6%.

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Pete Strong continued his presentation, and made the following points supporting his conclusion that additional funding should be contributed to the plan exceeding the minimally required amount:

- The long-term funding policy, with the surtax stretching to 2060, and funding down over 30 years, leaves room for a lot of risk between now and then.*
- All members will become retired before the 30 year horizon;*
- The plan will not be fully funded by the time all members are retired.*
- Every forecast shows the 10 to 15-year investment horizon producing less than the 7% return benchmark.*

Pete Strong said he will be recommending to the Board of Trustees that the plan lower its 7% return assumption at its meeting next week.

Pete Strong said this is a long-term consideration. The 7% return assumption is not sustainable for the long term. The unfunded liability will be driven upwards more than expected by the compounded-average return actualizing at less than 7% annually. Although the Board may not be ready for a formal recommendation, this is something we are going to talk about during the next year – what would an appropriate assumption be?

Timothy Johnson cautioned Pete Strong and said the Board took action quickly on his recommendation to smooth asset return values. This should be something to begin thinking about, which is different than taking immediate action.

Timothy Johnson asked Pete Strong to come back to the FIAC and discuss the implications of lowering the return assumption.

Pete Strong said this would be a process. Wilshire should weigh in as well. GRS has started collecting more and more market forecasts from consultants – 12 consultants are now used – for each asset class and volatility for each. GRS loads this data into a model along with the target asset allocation. When this is done for the PFPF, the average return comes in below 7%.

Pete Strong said this is one of the reasons why he wants to begin consideration of lowering the return assumption below 7%.

David Lindberg said Wilshire will run their capital market assumptions on the PFPF's asset allocation policy and provide those numbers on a 10-20 year horizon. These assumptions are revised quarterly and finalized close to January.

Pete Strong said Wilshire is one of the 12 consultant firms which have been input into GRS's database of market forecasts used for the model. These forecasts are collected once a year. Wilshire's forecast was collected either last Spring or Summer.

Brian Smith asked Pete Strong to cover any other highlights he may have.

Pete Strong discussed Actuarial Standard No. 51, a new standard covering risk, which became effective in November 2018. It is a general recommendation, although not required, to conduct a

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numerical risk assessment once every 3-5 years including stress and scenario testing to assess in which areas the plan is most exposed to risk, should risk events occur.

Rodney Van Pelt made a motion to recommend approval of the Actuarial Valuation to the Board of Trustees, emphasizing that the Board of Trustees request the City to consider an additional contribution exceeding the minimally required amount. Seconded by Rob Kowkabany. The vote passed unanimously.

At this point in the meeting, all attendees by phone were dismissed.

Brian Smith said he did not expect Pete Strong to recommend lowering the return assumption. This is something to talk about at some point – although it should be discussed with the FIAC Chair, the Board Chair, Pete Strong, and Timothy Johnson before it is brought to the FIAC for a vote.

Timothy Johnson said he could not agree more. All eyes are on this Actuarial Valuation. It's basically a \$140 million bill to the City he will have to present to City Council.

Brian Smith said the return assumption is clearly something GRS recommends, and something that should be vetted in the FIAC sometime this year. He asked Timothy Johnson to put it in the FIAC's work plan for 2019.

Rodney Van Pelt said the FIAC just looked at the return forecasts in Summit Strategies Asset – Liability Study 6 months ago. Summit Strategies said the Fund could achieve a 7% return. Brian Smith makes a good point in that the FIAC should consider lowering the return assumption over the next 3-6 months and make a recommendation to the Board of Trustees. Although it is not something to 'jump on' today.

Rob Kowkabany asked if Pete Strong touched on this point in the Actuarial Valuation report.

Timothy Johnson said he did not, and that is why this recommendation to lower the return assumption caught him off-guard.

Timothy Johnson discussed a project he is working on with Pete Strong – a stress test model, including variables related to the plan's liability. Variables include the smoothing method, surtax growth rate assumption, payroll growth rate assumption, the return assumption of the plan, and the City's other two plans, etc... This would be a tool that we could use to play with certain variables and see in real time the universal impact.

Rodney Van Pelt said he would like to receive a notification whenever either of the City's other two plans make changes in their assumptions which affect the PFPF.

Timothy Johnson said that the other two plans have an incentive to underperform, as it increases their share of the future surtax proceeds.

Rodney Van Pelt said real money today is associated with these assumptions, although the big money is supposedly down the road.

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Timothy Johnson said it is a balance – there could be a small piece today and a big piece later, or vice versa.

Timothy Johnson returned to the directed brokerage topic. The Board is asking the FIAC that if it wants to approve minority managers, then select them and include them in the selection process for interviews. It is up to the FIAC, and will not be explicit in the Statement of Investment Policy, as the Office of General Counsel says the PFPF would receive 'reverse' discrimination lawsuits if it were included in the policy. The City has received such cases before.

Brian Smith asked if there would be no language related to targets. First, there were targets, then there was size language, and now the FIAC is empowered?

Timothy Johnson said the meat would come from the FIAC. Northern Trust has provided the diverse brokers. The FIAC should direct Wilshire to include diverse managers in searches to interview.

Brian Smith said his original position on the matter was to either put explicit language in the Statement of Investment Policy related to diverse managers and brokers, or to leave all language out and leave it up to the FIAC to bring diverse managers to interview. He said he is fine with leaving the explicit language out of the policy.

Rob Kowkabany said he is fine with this solution. This is the culture of the FIAC – the committee just has to do what it wishes, and recommend diverse managers to the Board of Trustees.

Rodney Van Pelt said the FIAC has to get measurements from Wilshire relating to how much brokerage is minority-driven. We do not have anything like that yet. This is something that must be measured.

VIII. ADJOURNMENT

Chair Brian Smith adjourned the meeting at 5:25PM.

Steve Lundy, Assistant Plan Administrator
Posted 01/16/2019
Revised 02/04/2019

Craig Lewis Sr., Secretary
To be approved at the FIAC Meeting on February 15, 2019.

The next regular FIAC meeting will be held Friday, February 15, 2019 at 3:30PM.