OTHER POST EMPLOYMENT BENEFITS (OPEB) BOARD

The Other Post-Employment Benefits (OPEB) Board meeting was held on August 15, 2012 at 3:00 p.m. with Chairwoman Williams presiding. Members present were Mr. Hare, Mr. Koenig, and Mrs. Mitchell. Mrs. Hawkins was absent. Councilman Perza was also present.

AGENDA ADDITIONS/DELETIONS

By unanimous consent, the agenda was approved as presented.

ADOPTION OF MINUTES - OPEB BOARD MEETING OF FEBRUARY 8, 2012

Mr. Hare moved for adoption of the minutes of the OPEB Board meeting of February 8, 2012, seconded by Mrs. Mitchell and unanimously carried.

ORGANIZATIONAL ISSUES - ELECTION OF CHAIR

Mrs. Williams opened the floor for nominations for Chair.

Mr. Hare moved to nominate Mrs. Williams to serve as Chair. Mrs. Williams respectfully declined.

Mr. Hare moved to nominate Mrs. Donna Mitchell, Controller/Treasurer, to serve as Chair, seconded by Mrs. Williams.

Mr. Hare moved to close nominations, seconded by Mr. Koenig and unanimously carried.

The motion to elect Mrs. Mitchell to serve as Chair of the OPEB Board was unanimously carried.

QUARTERLY PERFORMANCE REVIEW *(QUARTER ENDING JUNE 30, 2012) (MILLIMAN, INC.)*

Mr. Jeff Marzinsky, Principal and Employee Benefits Consultant, Milliman, Inc., reviewed the Quarterly Performance of the OPEB Trust Fund as of June 30, 2012. He noted that the fund balance was approximately $8.43M at the beginning of the quarter and the ending balance was approximately $10.48M, including contributions of approximately $2.15M. Mr. Marzinsky stated that there was a slight gain during the quarter due to the timing of the contribution. He indicated that the majority of investments, including passive index investments, ranked well and exceeded their benchmarks during this time period and that no changes in investments were recommended at this time.

DISCUSSION - LIABILITY TO ASSET ALLOCATION STUDY *(MILLIMAN, INC.)*

Mr. Jeff Marzinsky, Principal and Employee Benefits Consultant, Milliman, Inc., reviewed the City of Dover, DE - OPEB Asset Liability Study, dated July 31, 2012. He advised members that two (2) factors affect the plan assets: the liability stream (future payments) and the risk/return profile of the assets in the plan, and Milliman considers both when conducting analysis. Using data provided by Mr. Scott Porter, Milliman's actuary, annual projected benefit obligations were used to develop a statistic called duration, which indicates when (on average) payments will be due. Mr. Marzinsky reminded members that the plan has a projected target return of 7% that is used for actuarial valuation and to develop an optimal portfolio.

Mr. Marzinsky explained that the Optimization Input Review on Page 2 of the report listed the projected returns and projected volatility (standard deviation) of OPEB fund investments. He advised members that the Input Correlation on Page 3 reflected how closely the investment asset categories move together and that a correlation of 1.00 indicates an exact match. He noted that assets should not move up or down simultaneously since maintaining diversification is important.

Referring to Page 4 of the report, Mr. Marzinsky indicated that the far right column reflected the OPEB plan's current investment allocations. He reviewed three (3) alternative options that were developed to allow members to consider which would add different asset categories and different allocations within categories. He noted that Option 2 reflected a reduction in stock allocation from 68.0% to approximately 60.73% and that allocating in this manner would create more diversification, hit the same target return, and lower the volatility of the portfolio. Mr. Marzinsky stated that approximately 32% of the portfolio was allocated to fixed income (bond-type) investments and 68% allocated to equities. He felt that this was a fairly good allocation, since weighing the plan more heavily in equities would provide more growth potential, although volatility would be higher.

Responding to Mrs. Williams regarding the relatively high standard deviation, Mr. Marzinsky stated that there would be a long window of time to potentially grow the portfolio, noting that the majority of benefits would become due in 20-30 years. In addition, he noted that growth would be needed within the portfolio and the equity investments would be helpful in this regard.

In response to Mrs. Williams regarding whether the standard deviation would decrease in the future, Mr. Marzinsky indicated that portfolios for pooled investments with a future liability are typically "de-risked" as the liability moves closer to a funded status. Equity is removed from the portfolio and fixed income is added, and this lowers the risk and the standard deviation. He estimated that this could be considered by the City in five (5) or ten (10) years and that Milliman would continue to monitor the status periodically to evaluate how well the plan is funded, how much the assets have grown, and the amount of contributions to the plan.

Mr. Marzinsky explained that the three (3) yellow dots on the graph on Page 5 reflected the three (3) optimal portfolio options. The blue dot, representing the current OPEB plan, indicated that it was not as efficient as the alternative scenarios presented. Page 6 showed the variability of potential returns for the dispersion of expected outcomes and demonstrated that adding the asset categories would reduce the likelihood of a wider dispersion of potential outcomes. Page 7 reflected expected future payments, which allowed for the development of the isolated duration number, which indicated that in approximately 24 years, the core of the benefits would begin to be paid.

Mr. Marzinsky explained that Page 8 revealed a mismatch in the duration of the assets and the duration of the portfolio. He recommended gradually transitioning to a liability-driven investment portfolio. He indicated that Page 9 contained an analysis of the optimal portfolio (Option #2) which would allocate some of the fixed income holdings to longer-term investments and achieve a better match in the duration of the assets to the duration of the liabilities. Mr. Marzinsky noted that the steps involved would be: 1) changing the allocation of the plan by adding different asset categories,

which would reduce the volatility of the portfolio and achieve an expected target return close to the valuation target return; and 2) allocating some of the portfolio to longer-term bond investments, which would start to match the duration of the assets to the duration of the liabilities within the plan.

Referring to the 24-25 year projected duration, Mrs. Williams expressed her concern that the money would come in after it was needed, since most employees would be retired or nearly retired by this time. Mrs. Mitchell explained that the City was in a ten-year phase-in period for funding the liability and these funding assumptions were built into Milliman's report.

In reponse to Mrs. Williams, Mr. Marzinsky stated that the implications of capping the fund would be considered on the actuarial side rather than the investment side.

Mrs. Mitchell stated that capping the fund would decrease the duration mismatch.

Responding to Mr. Koenig, Mr. Marzinsky stated that the 24.97 figure for duration was based on actuarial information, including participant data and when those benefits would come due. A schedule was developed of all payments to be issued in the next 70-80 years and dollar amounts were projected year by year. This data was run through a calculation that determined, on average, when the core or majority of benefits would come due.

In response to Mr. Koenig, Mr. Marzinsky confirmed that the targeted 7% return was very optimistic in the current market. He noted that diversifying into different asset categories would increase the likelihood of meeting target returns. He stated that he was not aware of fixed asset investments that were currently yielding this rate of return; however, some were generating this amount of return based on share price in terms of the net asset value of portfolios.

After further discussion, in response to Mr. Hare, Mr. Marzinsky recommended Option #2 as a "middle of the road" strategy for allocating the OPEB portfolio. He suggest that consideration be given at a subsequent meeting to setting high and low thresholds for each of the asset categories so that the portfolio would not have to be rebalanced frequently.

Mr. Hare moved to adjust the portfolio by adopting Option #2, as outlined on Page 4, Portfolio Options, of the City of Dover, DE OPEB Asset Liability Study dated July 31, 2012 *(Attachment #1)*. The motion was seconded by Mrs. Williams and unanimously carried.

SCHEDULING OF FUTURE MEETING DATES

By unanimous consent members agreed that staff would set future meeting dates and coordinate with members.

Mrs. Williams requested that adequate time be allowed for meetings so that members could consider matters thoroughly.

Mr. Koenig moved for adjournment, seconded by Mrs. Williams and unanimously carried.

Meeting Adjourned at 3:38 P.M.

Donna S. Mitchell
Chair

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Attachment
Attachment #1 - Page 4, Portfolio Options - City of Dover, DE OPEB Asset Liability Study dated July 31, 2012

Milliman | Asset Allocation Study

Portfolio Options

	Option 1	Option 2	Option 3	Gen EE & Police Pension	OPEB
Cash	5.000	5.000	5.000	2.000	1.000
ML U.S. Treasuries, Inflation-Linked	7.000	7.000	7.000	0.000	0.000
Barclays Capital Interm U.S.Govt/Credit	10.000	10.000	10.000	34.000	31.000
Barclays Capital Long Gov/Credit Index	20.000	17.268	12.287	0.000	0.000
Russell 1000 Value Index	12.117	10.000	11.344	14.000	10.000
Russell 1000 Growth Index	10.000	10.738	14.369	14.000	15.000
Russell Midcap Index	5.000	5.000	5.000	8.000	11.000
Russell 2000 Index	5.000	5.000	5.000	5.000	7.000
FTSE NAREIT REIT: Equity	5.000	4.994	5.000	0.000	0.000
MSCI EAFE (Net) Index	10.000	10.000	10.000	23.000	25.000
MSCI EM (Emerging Markets) Index	10.883	15.000	15.000	0.000	0.000
Fixed Income	**42.00%**	**39.27%**	**34.29%**	**36.00%**	**32.00%**
Equity	**58.00%**	**60.73%**	**65.71%**	**64.00%**	**68.00%**

	Option 1	Option 2	Option 3	Gen EE & Police Pension	OPEB
Expected Return	6.75%	7.00%	7.25%	6.70%	7.00%
Expected Standard Deviation	11.3045	12.1307	13.0225	12.1951	13.1609
Expected Sharpe Ratio	0.3760	0.3710	0.3648	0.3444	0.3422

