Old Saybrook Pension and Benefits Board Meeting
Thursday, March 28, 2024
8:30 a.m.
Second-floor Conference Room, Town Hall – Hybrid Meeting
To access the audio from this meeting, please use the following link:
https://youtu.be/4Pmx3QuwCEo

Meeting Minutes

Attendees

Members Present:
Darrell Pataska
Carl Fortuna, First Selectman
Susan Quish
Rowena Moffett
Paul Tracey
Loraine Cortese-Costa
Leland Mckenna

Others Present:
Lee Ann Palladino, Finance Director & Pension Plan Administrator
Janet Vinciguerra, Pension Board Liaison
Kevin Nichols, Morgan Stanley Investment Advisor
Rebecca Lilly, Morgan Stanley Investment Advisor
Becky Sielman, Milliman Actuary
Andrea Brundrett, Administrator

Absent:

Welcome and Public Comment

The meeting was called to order at 8:30 a.m. by Mr. Pataska. No members of the public were present.

Approval of the Minutes

The minutes of the February 22nd, 2024, meeting of the board was reviewed. Mr. McKenna mentioned that the minutes stated he is a current member of the Chamber of Commerce, when he is a past member. Mr. Tracey motioned to approve the minutes with the change of Mr. McKenna's current status on the Chamber of Commerce. Ms. Quish seconded the motion and the motion passed unanimously.

Milliman Actuarial Review

Ms. Sielman started by reviewing the Town of Old Saybrook Retirement Plan, going over the plan members as of July 1st, 2023. The membership graph shows 23 terminated members, 95 members in pay status, and 72 active members. The active members are broken down to 22 BOE employees, 23 Police Department Employees, and 27 Town employees. Ms. Sielman added that the numbers of active members have gone down while the number of members in pay status have gone up due to new employees with the town and BOE not being eligible for the pension plan, since the town switched to a Defined Contribution plan. Only new employees of the Police Department are eligible for the pension plan. She continued, throughout 2022 to 2023 there was an uptick in active members who terminated employment. They usually seen a turnover of 2-4 people but over the course of that year the Town of Old Saybrook had 10, which is more than they would normally expect to see. This is also why the liability did not go up as much as expected. On the other hand, not as many active members retired, 2 in total, in which they normally expect around 10. Ms. Sielman said they normally expect 2-4 retirees to have passed away where from 2022-2023 only 1 retiree passed away. She continued that as of July 1, 2023 95 retirees were collecting almost $2 Million in retirement. Ms. Sielman then went over assets with a graph that showed the last 5 years of performance. 2020-2021 showed a return of 27.92% while 2021-2022 show a return of -14.67%. 2022-2023 showed a return of 9.90% which Ms. Sielman said is better than their average client and well above the actuarial expected return of 6.75%. She continued, the Town Contributions of $838,725 for 2022-2023 were larger than the actuarial determined contributions which was $789,000. Ms. Sielman then showed the balance of each plans assets as of June 30th over the past 5 years. One bar showed the market value and one bar showed the actuarial value. The actuarial value is calculated by recognizing any market gains or losses gradually over a 5-year period. They use this value to report on how well the Town's plan is and to calculate how much the Town should contribute in the following fiscal year. Mr. Fortuna asked, with the actuarial value being a Milliman projection, if that is proprietary information. Ms. Sielman said it is not and that it is a common smoothing method used by most public pension plans in asset smoothing mechanisms. She added there are two predominant ways of doing the smoothing, they've chosen this way because it is straightforward to understand how they go from market value to actuarial value so the math can be followed. Milliman projected expected a rate of return of 6.75% with investment income to be $1,614,170, the actual investment income for 2022-2023 was $2,367,450 which is a market gain of $753,280. Mr. Pataska asked, with the actuarial value showing a balance of $27.2 Million as of July 1st, 2023 and the actual value as of February 29th, 2024 being $27.126 what does that mean. Ms. Sielman said that just means the Town is having a good year so far, all of Milliman's calculations are as of July 1st, 2023 so they don't include anything that's happened since then.

Ms. Sielman then reviewed the Interest Rate Assumption which shows a projection of what benefits Milliman expects to be received, by whom, and for how long. This gives an idea of the benefits that will be paid from the plan in the coming decades. She explained that those future benefits need to be shown in today's dollars, so they discount from the future to the present using an interest rate assumption that Milliman designs to be their best guess, with respect to the long-term future investment returns that the portfolio is expected to earn. The Asset Allocation graph shows a pictorial representation of the target asset allocation, with a mix of lower risk fixed income shown in green and higher yielding/higher volatility equities shown in blue. The sizes of the bubbles show how much is allocated to each asset class, the location of the bubbles shows the expected annual return and the volatility of those returns. Each year Milliman looks at what they expect those asset classes to earn on a going forward basis, based on current market information. The Distribution of Expected Returns graph looks at the expected lifetime of the plan. With the 5-year projection there can be a wide swing of investment performance with markets being volatile. As you look at longer time projections there's more time for good and bad years to balance out, so the range of compound returns shrinks the further you look out into the future.

Milliman looks at the 50th percentile or the average based on the plan's portfolio, which shows a rate of return of 6.8% based on June 30th ,2023 capital market assumptions. This year showed no change in the interest rate assumption, where in the past they have advised to reduce the interest rate assumption. Mr. Pataska asked how Milliman determines these numbers. Ms. Sielman explained the have investment consultants and investment actuaries along with information generated by external sources to come up with the Capital Market Assumptions. Their committee updates this analysis every 6 months. Some of this information is also included in the Town's Annual Comprehensive Financial Report. Ms. Sielman then went over the Funded Status report which looks at the liability and assets side by side. This includes an Accrued Liability graph which shows how the liabilities have grown over the past 5 years. Milliman projected the liability to be at $32.2 million for 2023 but it is actual at $32.0 million, showing a slight gain because of the higher level of turnover. The Funded Ratio graph shows the actuarial value of assets to the accrued liability, which went from 85% in 2022 to 85.2% in 2023. Ms. Sielman said 85.2% puts this plan in a very nicely funded position and is better than many municipal plans in Connecticut.

Ms. Sielman then looked at the Actuarially Determined Contributions, in which each valuation is used to calculate an actuarial determined contribution for the Town to make in the fiscal year that starts one year later. This way the dollar amount is determined before the budget is worked on for that fiscal year. The actuarially determined contribution has dropped from $844,066 in 2023-2024 to $753,118 for 2024-2025, as shown in the upper graph. The lower graph shows the breakdown of the actuarially determined contribution. Normal cost is the cost of the benefits being earned each year by active members, net of the amount the members themselves are contributing to the pension plan. Past service cost is an amortization payment to gradually pay off the unfunded accrued liability over a period of time and finally the interest earned. Ms. Sielman said the biggest change from last fiscal year to this fiscal year is the normal cost decreasing because the Police Department headcount dropped. With the PD having the most generous benefits provided by this plan, the normal cost per active police member is higher than the normal cost per Town or BOE member. As those open PD positions are filled the normal cost will likely go back up to its prior level. Mr. Fortuna asked what period of time that headcount measurement is being taken. Ms. Sielman said that is the headcount as of July 1, 2022 versus the headcount on July 1, 2023, so if those open positions have already been filled, that is not reflected in this calculation. Ms. Palladino added that there are two current officers that chose to participate in the defined contribution plan opposed to the defined benefit plan. Ms. Sielman continued that there was also a slight uptick in the employee contributions being paid to the plan as a result of the bargaining units. The math on page six shows the impact of the updated employee contributions which shows an increase of about $5,000 for the expected employee contributions, which reduces the net normal cost and the actuarially determined contribution. Mr. Pataska asked Ms. Palladino what is in the proposed preliminary budget. Ms. Palladino said the Town has budgeted $707,000, the BOE has budgeted $180,000 for a total of $887,000; versus the $753,000 which is $134,000 more. She added that the budget has passed so these numbers are locked in. Mr. Fortuna added that they thought the total might be lower but it was a policy decision made with Ms. Palladino to not reduce the budget with the market going up and down.

Ms. Sielman went on to review the Fire Department Retirement Plan, valuations for this plan are done every two years. During that time 14 active members left service, 4 of those active members started collecting benefits. No retirees passed away but 1 active member passed away in that 2-year period. When referring to the assets Ms. Sielman said the values are shown in thousands on this graph, with the same asset smoothing technique as the town retirement plan. The expected rate of return for the FD plan is 6.5%. Ms. Sielman then showed the Interest Rate Assumptions graph with an expected rate of return of 6.8% over the next 30 years. She continued to the Funded Status graphs, which showed the liability for this plan has been growing more quickly because there are more active members earning benefits. The funded ratio has improved from 45% to 55%, which is good improvement but not a great funded ratio. The actuarially determined contribution went from $187,258 in 2023-2024 to $194,407 for 2024-2025, and $207,043 for 2025-2026. Because these are done every other year, these numbers determine the contributions for the following two fiscal years. Mr. Pataska asked Ms. Palladino what is in the budget for 2023-2024. Ms Palladino said there is $214,000 versus the $194,000, about $20,000 higher than anticipated. She added that Ms. Sielman had provided this information when the cost-of-living increases were done. Ms. Palladino also suggested the pension board think about doing these valuations on even years so the cost-of-living changes can be taken into consideration with these numbers. Ms. Sielman then referred the math breakdown on page six pointing out one change that was made this year to the mortality assumption, which is an assumption as to how much life expectancies will continue to lengthen in the future. The Society of Actuaries periodically issues an update mortality projection scale, the MP 2021 is the most recent. She continued this represents some pullback in future improvements in longevity resulting in a slight reduction in liability. This reduced the actuarially determined contribution by $504. Ms. Cortes-Costa asked about the increase in expenses to the FD plan and what goes into that number. Ms. Sielman explained that Milliman looks at what was paid in administrative expenses since the last valuation. For the FD they look at the last two years, average those numbers and account for inflation. In this case there were higher than normal expenses that was paid out of the FD assets in the last two years which may have been a result of the COLA study. Ms. Palladino added that the COLA study was part of those expenses and that when someone investigates retirement, they include that as well in which they had several over that two-year period.

Pension Liaison Report

Ms. Vinciguerra reported that for the March pension gross payroll the town had 99 retirees with a gross monthly payroll of $166,275.23, with one addition of Julie Pendleton with the BOE. Ms. Pendleton's retirement was as of February 1st so she received 2 months of benefits. There is a total of 100 participants with one QDRO spouse. The Fire Department has 37 retirees for a gross monthly payroll of $14,022.44. There is a total of 38 participants with one QDRO spouse.

At the time of this report there were no pending retirements. Ms. Vinciguerra was recently informed of Richard Champlin's retirement from the transfer station, taking effect on May 1st. Chief Mosca's passing will also reduce April 1st payroll numbers.

As of March 15th, 2024 the defined benefit plan has 46 contributing town employees and 21 contributing BOE employees. The defined contribution plan has 43 town employees and 21 BOE employees. 82% of DC participants elected the optional town match. Mr. Tracey acknowledged that the number of participants electing the additional match again went down. Ms. Vinciguerra said she has been working with Ms. Lilly to reach out to those employees not opting the additional match, and provide them with information on why it is beneficial for them to participate. She added a majority of those not opting the additional match are part-time. Ms. Lilly added that they have reached out to those employees already and provided them with additional information about match and the benefits of participating. She said they will continue to reach out to those employees.

Investment Advisor Report – Morgan Stanley

Mr. Nichols started by reviewing the Wealth Management Perspectives. Referring to the Executive Summary, under Major Investment Controversies, the equity market is saying the path of inflation is under 2%. Mr. Nichols said this is not true and that inflation is trending upward. Under terminal policy rates the Equity Market is expecting sub-1% real rates on 10-year, Morgan Stanley believes it will be about twice that much and higher for longer means lower valuation multiples. With that he added the market continues to defy expectations, regardless of the data coming in it continues to go higher, currently being at 21 times earnings. Mr. Nichols said the expected number of rate cuts coming into the year is between six and seven, we are currently at 3.8. When referring to the Core CPI, Annualized, he showed the board that the 3-month trend and the 6-month trend have both trended up since last fall so Morgan Stanley expects inflation to be very sticky. When looking at the inverted yield curve Mr. Nichols said it has been this way for over two years now, which is the longest in 45 years. The last few times this has happened we've gone into a recession, but the market is not expecting a recession at this point. He added we could see a recession at the end of this year/beginning of next year depending on the election and where federal spending is allocated. Morgan Stanley's S&P 500 Still Remains at 4500 which is about a 15% decrease from where they are now which is why they are more balanced in terms of risk in the fire and town pension portfolios.

Ms. Lilly then reviewed the report for the town pension which as of February 29th, 2024 has a balance of $27,126,492. Fiscal year to date, the portfolio is at an increase of 9.3%. Mr. Pataska expressed concern at the percentage of return net of fees which is at 7.27% opposed to the IPS benchmark of 8.79%, he asked if someone inquired as to why that is 150 basis points less what would the answer be. Mr. Nichols said if you look back to 2022 the percentage was over 150 basis points to the IPS, there is less risk than the IPS with 30% of that benchmark in the S&P 500. He continued a lot of capital tends to flow into the new industries, in this case AI, but with that the revenue expectations get too high for them to deliver which is when valuations come down. Mr. Pataska said he understands the reason the portfolio is off from the S&P 500 but he's wondering why we are so far off from the IPS that the board created. He added that in the IPS they stated the portfolio would remain conservative and not follow trends but the portfolio is still off 150 basis points. Mr. Nichols referred to the S&P 500 which is the US Large Cap benchmark and it is 30% of the target but is currently at 23.36% in asset allocation and has been underweight for quite some time. This has hurt the portfolio performance relative to the IPS benchmark and relative to the 60/40. When going back to performance inception, return percentage net of fees has averaged 6.17% in the portfolio and the 60/40 has been 6.38% which is a difference of 21 basis points over a 25-year period. This is more in line with the ebbs and flows of the market. Mr. Nichols continued, when looking at the Risk vs. Return graph it is much closer to the IPS benchmark, with slightly higher risk than the benchmark but with benchmark returns. Mr. Nichols said that if anyone would like to sit one on one and talk further about why the portfolio is underperforming and the risks they are taking, he would be happy to do that as well. He added the cash flow study will also be done in the next two months but because of the reduction in the Town's ADAC and because of the increase in the cash flow the portfolio is earning, about 40% of the benefit payments are covered just from the cash flow, which is up from 30%

about two years ago. This is excluding town and employee contributions. Mr. Pataska added that with the IPS review in April and what type of risk will be taken in the portfolio, that this year we have gone overboard in reducing the risk to the detriment of the portfolio's return. This is why the portfolio is not earning what the IPS says it should. With that Mr. Pataska asked why are we taking less risk and not following the IPS. Mr. Nichols said the IPS is being followed since there are minimums and maximums that Morgan Stanley is allowed to deviate from inside the IPS. The only asset class that has been over is short-term bonds which has been a net positive over the last five years. He added that the portfolio is underweight in the S&P 500 and a lot of the underperformance the portfolio has had is due to not being in the AI stocks with the Magnificent 7 being up 70-80%. Mr. Nichols said he does not advise performance chasing at this juncture and is focusing on how to position assets going forward. They believe the S&P 500 is rich which is why the portfolio is underweight in that asset class, being overweight in US Small Cap has been beneficial, overweight in Developed International has been beneficial, overweight in Emerging Markets which has not been beneficial, and overweight in short-term bonds which has been beneficial. Mr. Tracey asked if being underweight in the US Large Cap is due to the bias Morgan Stanley has had with this market strategist. Mr. Nichols said no because they do take that information with a grain of salt. He added that Morgan Stanley just released their update of Annual Capital Market Assumptions and in the past, they have advised to reduce assumptions when the market is bad but when the market is good, they advise to increase assumptions which is counter cyclical to what they should be doing. When price earnings are higher expected future returns are going to be lower and when price earnings are low that means expected future returns should be higher. With that Mr. Nichols does believe the Fed will be higher for longer and that the market is too concentrated at this time. Mr. Pataska said that as the board reviews at the IPS they need to take a closer look at AI because of the industries it's impacting it may have long-term benefits. Another asset class he would like to look at is utility companies because of the demand for more computing centers to cover electric costs. He clarifies that he doesn't want to trend chase but thinks there should be some asset allocation towards this. Mr. Pataska expressed his concern in regards to emerging markets, Morgan Stanley has advised asset allocation in EM because of future returns but Mr. Pataska does not see this happening anytime soon and does not feel the portfolio should have 10% allocation in EM. Mr. Nichols said that as of yesterday EM is outperforming benchmark at 3.35 YTD versus 1.70 for the benchmark. He also advised to research IBM stock in the 80s because the way AI stocks are trending are mirroring the trends of IBM stocks and their performance from 1980-1990. He also said that part of the portfolio is participating in AI with the S&P 500 iShares Core ETF which would be about 3% asset allocation. In terms of utilities, Mr. Nichols said they pay a very good level of dividend and much higher dividends than the average S&P 500 company. He would say the portfolio is overweight in relation to the S&P 500 benchmark in this case, with utilities doing more poorly over the last year. Mr. Fortuna said he is happy with the interest and dividends not including town contributions that end up paying the benefits, and that is something that is reassuring to him.

Mr. Nichols went on to discuss replacing the mid cap manager Nuance, since that has not been beneficial to the portfolio, with it being down while the rest of the market is up. He also wanted to mention when looking at the fixed income, which they moved money to for more protection, with yields at 5.7% while taking one third of the amount of risk to the S&P 500 that they are very happy with the return on the fixed income. Mr. Pataska asked, in terms of asset allocation what are the alternatives included in the $454,746.85. Mr. Nichols said alternatives are real estate investment trusts and master limited partnerships that the S&P 500 split because their tax structure is alternative. They have to pay out 90% of their earnings as a distribution to their shareholders whereas corporations do not have to do that. Mr. Tracey asked what Mr. Nichols preference would be for the replacement for the mid cap manager. Mr. Nichols said his suggestion is the Kayne Midcap fund because it is a midcap core fund which means it can go between value and growth. It also has very good long-term performance at about 13.39% per year. The board agreed that replacing mid cap manager Nuance with Kayne would be beneficial to the portfolio.

Plan Administrator's Report

Ms. Palladino reported that next month they will have the cash report from Morgan Stanley and that we will not be doing the IPS review in April. With the concerns around the IPS, Ms. Palladino said it is a combination of where the portfolio is positioned and because of the age of the participants the portfolio may need more cash related investments which should be taken into consideration. She also suggested that they may want to take a look at active versus passive management, passive management is higher risk while active managers have been reducing the risk but have affected the portfolio. She would like to discuss this further and have Morgan Stanley run models that would make everyone more comfortable with the performance. Mr. Pataska agreed with Ms. Palladino's suggestion.

Old Business

No old business

New Business

Mr. Pataska made a **motion** to adjourn seconded by Mr. Tracey, all were in favor and the meeting adjourned at 10:06 a.m.

Respectfully submitted,

Andrea Brundrett, Recording Secretary

The next meeting will be Thursday, April 25, 2024, at 8:30 a.m. by hybrid meeting format in the Town Hall, first-floor conference room.