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STATE BOARD OF PENSION TRUSTEES
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BOARD OF PENSION TRUSTEES
MEETING MINUTES OF JUNE 18, 2004

The meeting of the Board of Pension Trustees was called to order by P. Reese at 9:02 a.m. in the Delaware Conference Room of the McArdle Building.

Trustees Present

Phillip Reese
Robert W. Allen
David W. Singleton
Nancy J. Shevock
Helen Foster
Jan King

Trustees Absent

Lisa Blunt-Bradley

Others Present

Jim Testerman, Pension Advisory Council
Charlotte Lister, Pension Advisory Council
Joseph Malloy, Pension Advisory Council
David C. Craik, Pension Office
Kim Vincent, Pension Office
Alice Simon, Pension Office
Kathy Kunkle, Pension Office
Theresa Leatherbury, Milliman USA

1. OPENING COMMENTS

The meeting of the Board of Pensions Trustees was called to order at 9:02 a.m.

2. APPROVAL OF THE MINUTES

The Trustees reviewed the minutes of the April 30, 2004 meeting.

MOTION was made by J. King and seconded by H. Foster to approve the minutes of the Board of Pension Trustees' meeting.

MOTION ADOPTED UNANIMOUSLY

3. ACTUARIAL REPORT

Theresa Leatherbury from Milliman USA, who is the actuary assigned to the Delaware Public Employees Retirement System, presented two reports.

1) Review of Actuarial Assumptions for Salary

Theresa provided a graph of wage rate increases and service for merit salaried employees. The experience and proposed assumptions were inline with rates declining as the employee approached 10 years of service. Current assumptions were slightly off.

Findings for 9-year period from 1994 through 2003 indicated:

- National wage inflation was about 4.3%
- Wage inflation for Delaware State Employees' Plan was about 3.7%
- CPI was about 2.44%
- Delaware's average wage increase is about 60 basis points less than the national average

Findings for the period from 1991 through 2003

- National wage inflation was about 3.9%
- Wage inflation for Delaware State Employees' Plan was about 3.4%
- CPI was about 2.55%
- Delaware's average wage increase is about 50 basis points less than the national average

Recommendation for wage inflation

- Wage inflation from 1951 to 2002 averaged 4.97%
- CPI over the same period averaged 3.87%
- Delaware's average wages are about 50 basis points less than the national average over the past 12 years
- Best estimate of future CPI is 3%
- Best estimate for future wage inflation using national averages is about 1% higher than CPI (or 4%)
- Best estimate for future wage inflation for Delaware is about 50 basis points higher than CPI (or 3.5%)
- This is based on the information from GASB reports as well as input from the Board of Pension Trustees that Delaware wage inflation is less than the national average

Experience Study Results as of July 1, 2003 actuarial valuation indicate that Total Plan costs as a percent of payroll as of July 1, 2003 was 4.91%. With this new salary assumption, new assumptions with 8.25% interest return produces a total plan cost as a percent of payroll to be 3.03% and a 8.0% interest return produces a total payroll cost of 4.55%.

After much discussion, the Board decided to make no changes until after reviewing the actuarial valuation using the recommended assumptions and the FY04 actual investment return.

T. Leatherbury was asked to provide at the next meeting salary assumptions for the New State Police Plan and the Judicial Pension Plan along with a comparison to the State Employees' Plan. She was also asked to provide assumptions for other State plans where changes have occurred.

2) Other Post Employment Benefits

T. Leatherbury also provided a report of State of Delaware Retiree Health Liabilities as of July 1, 2003 under GASB Exposure Draft.

The valuation started with assets of \$10 million in the retiree health care fund as of 7/1/03 and assumed no additional deposits to the fund and no benefits paid from the fund. Assets were assumed to grow at the discount rate of 8.5%. The unfunded actuarial liability was amortized over 30 years with payments increasing 4% per year.

Economic assumptions included payroll growth rate of 5.8% and medical cost increase rate of 12.0% from 7/1/03 to 7/1/04, grading down 0.5% per year to a 6.0% ultimate rate.

Under GASB exposure draft, the Annual Required Contribution (ARC) is equal to the normal cost plus the amortization of any unfunded past service liability. Delaware is not required to contribute the ARC to a fund. The accounting standard will require employers to report the annual OPEB cost based on the ARC.

As of 6/30/04, the estimated premium payments for all retirees, less estimated retiree contributions totals \$67,000,000. The estimated underlying cost for all retirees after removing implicit subsidy, less estimate

retiree contributions is \$72,700,000. Estimated ARC calculated in accordance with the GASB exposure draft is \$195,300,000.

If Delaware's payments to the plan are less than the ARC, Delaware would have a liability for Other Post Employment Benefits (OPEB) on the financial statements. The liability starts at zero at the effective date and will accumulate over time as the difference between the ARC and benefit payments.

If the accounting requirement was effective 7/1/03 and Delaware does not make any payments to the plan other than benefit payments, the OPEB obligation on 6/30/2004 would be \$122,600,000. By 6/30/2014, the obligation would be approximately \$1,822,900,000; by 6/30/2024, approximately \$5,377,900,000; and by 6/30/2034, approximately \$12,611,400,000.

4. DEPUTY ATTORNEY GENERAL REPORT

There was no Deputy Attorney General Report as M. Kramarck was absent.

5. INVESTMENT COMMITTEE REPORT

INVESTMENT PERFORMANCE – MONTH ENDING MAY 31, 2004

<u>Fund</u>	<u>Previous Month</u>	<u>Fiscal Year To Date</u>	<u>12-Month</u>
Total Fund	0.5%	14.1%	15.2%
S & P 500 Index	1.4%	16.8%	18.3%
60/35/5*	0.6%	9.6%	10.3%
Delaware Benchmark**	0.5%	10.7%	11.5%

*Benchmark mix of 60% S&P500 Index, 35% Solomon Long Government and Corporate Bond Index and 5% T-bills.

**Benchmark mix of 45% Russell 3000, 10% EAFE (international), 43% Lehman Bond aggregate and 2% T-bills.

Total assets in the fund at the end of May totaled \$5.443 billion. The month of May was strong in most equity markets but did not make up the losses from April. The Russell 3000 stocks gained 1.4%, Large Growth stocks posted a negative 1.9% and Large Value index returned 1.0%. Small cap stocks posted positive gains with the Russell 2000 returning a 1.6%. The international markets stayed behind the U.S. market with the unhedged EAFE returning a positive .3%. The bond market, with rising interest rates experience negative returns for the month with the Lehman LT Government/Corp Index losing a negative .7% and the High Yield sector returned a loss of 1.3% as spreads begin to widen.

The fiscal year returns year to date for the Fund continues to be ahead and will be reported at a 14.1% gain, compared to a 10.7% benchmark. The positive variance to benchmark is mainly due to the high U.S. equity and International Equity position of the Mellon-TAA and GTAA during months that experienced strong equity returns. Year to date calendar returns are an overall 1.8% comparing favorably to a benchmark of .8%.

The Investment Committee met last month with two convertible bond managers, Oaktree Domestic and International. Convertibles will continue to struggle with rising interest rate and bonds will decline in value as rates rise. This week, the Committee met with the new Chief Investment Officer of Legg Mason Capital Management. This was a followup to a personnel change within the organization. The next Committee meeting is June 23 and asset allocation and portfolio construction will be discussed.

A Periodic Table of Investment Returns using Annual Returns for Key Indices (1989-2003) ranked in order of performance (best to worst) was provided to the Board.

The Total Fund has a three-year average return of 4.8%; four-year return 2.0%, five-year, 5.7%; seven-year, 8.5%; and ten-year return is 10.5%.

6. PENSION ADVISORY COUNCIL

J. Testerman reported introduced a new Pension Advisory Council member, Joseph Malloy, who represents the City of Wilmington Firefighters. The next council meeting is 11/4/04 where new officers will be elected.

C. Lister added that pre-funding of health benefits is a primary concern of the council. Total compensation package, inclusive of retirement benefits, seems to be the mindset of new employees. A lot of people come to work for the state due to the entire benefit package. Health benefits are viewed as part of the retirement package.

7. PENSION ADMINISTRATOR'S REPORT

Medical Report

Comprehensive monthly reports were distributed and discussed covering disability applications and pensions reviewed by the Medical Committee for the month May 2004. There were 15 new cases processed in May and 24 new cases processed in June. Two employees are in the over 90 days category, but will be resolved shortly. There was a City of Dover police officer that was approved with a six-month review but a second opinion was requested for further review. The doctor giving the second opinion has requested \$750.00 fee up front. We are working to resolve this issue.

Legislation

PRI bill expected to be introduced next Tuesday, 6/22/04. This bill grants a 2% increase for all retirees effective 1/1/76 through 5/1/04 and a 2% or \$35, whichever is greater, to retirees effective prior to 1/1/76. There is an increase to 2.43% of employer contributions into the PRI fund to sustain the cost associated with this bill.

HB 462 is for the New State Police Plan. Currently, there is mandated retirement at age 55. There are three individuals who will have less than 20 years of service at age 55. Under present law, they cannot collect until they are age 62. This bill allows employees age 55 with 10 years to collect immediately upon termination.

HB 445 is for the Closed State Police Plan. Employees who terminated with less than 20 years of service prior to the mid 1980's were prohibited by law from withdrawing the contributions they made to the plan. This bill was written for one individual who had contributed approximately \$1,300.00. This figure, with interest, now totals approximately \$5,000. The Pension Office comment on the bill indicates that there are approximately 70 other employees in the same situation. This bill passed the House but will more than likely be tabled in the Senate and revisited in January for all employees in the same scenario.

There is also a bill for New State Police survivors who have health insurance coverage with zero percent of the premium paid by the State. There is currently one survivor who is 20 years old paying full premium for her health care. The member had four years of service. The bill will provide 100% of the State share for survivors of troopers who are killed in the line of duty.

There is also a bill to change the multiplier for the County/Municipal Police Plan. Currently, employees contribute until they have 20 years of service and then cease. The multiplier is currently 2.5% and is proposed to rise to 3.5% for the years after 20. If the multiplier is increased, the employees will contribute for the duration of their employment.

The budget bill includes an increase to \$150 per meeting for each member of the Board of Pension Trustees and other Board committees.

8. AUDIT COMMITTEE REPORT

R. Allen reported that the last Audit Committee meeting was on 5/5/04 where the annual audit entrance meeting was conducted with Ernst & Young. The Information Technology Audit will start in the last week of June. The financial audit will begin on 8/2 with the exit interview scheduled for 8/20/04. The presentation to the Board will occur at the 10/1/04 meeting.

Mr. Allen indicated that M. Kramarck discussed Code of Ethics with the Committee members.

The SECC sanction against E&Y was discussed with the E&Y representatives. The committee ruled there was no impact on DPERS.

9. PENDING ITEMS

D. Craik reported that the RFP for item #1, Disability Project, had been received and would be reviewed.

The following items were added:

Earnings code review with the PHRST payroll unit and M. Kramarck.
Best practices study

10. GOVERNANCE ISSUES

Discussion of governance issues was tabled in M. Kramarck's absence.

11. EXECUTIVE SESSION

There was no executive session

12. ADJOURNMENT

The next Pension Board meeting will be held on July 30, 2004 in the McArdle Building Delaware Conference Room in Dover, Delaware.

At 10:45 a.m. there being no further business,
MOTION was made by D. Singleton and
seconded by R. Allen to adjourn the meeting.

MOTION ADOPTED UNANIMOUSLY

Respectfully submitted,

David C. Craik
Pension Administrator

Phillip S. Reese
Board of Pension Trustees Chairman

