District of Columbia Retirement Board

Budget Oversight Hearing

Before the

Council of the District of Columbia
Committee of the Whole

April 14, 2016

OPENING REMARKS

Good afternoon, Chairman Mendelson and members of the Council of the District of Columbia Committee of the Whole. I am Sheila Morgan-Johnson, Acting Executive Director and Chief Investment Officer of the District of Columbia Retirement Board ("DCRB" or the "Board"). I would like to thank Trustee Michael Warren for his introduction and for taking the time to represent DCRB's Board of Trustees before this Committee. I will testify on our FY 2017 Budget.

Joining me today to respond to the Committee's questions are Anthony Shelborne, DCRB's Chief Financial Officer and Ed Koebel, of Cavanaugh Macdonald, our independent actuary. Other senior staff in attendance include Erie Sampson, General Counsel, Johnetta Bond, Chief Benefits Officer; Peter Dewar, Chief Technology Officer; and Joan Passerino, Director of Stakeholder Communication and Outreach.

DCRB was created by Congress in 1979 under the District of Columbia Retirement Reform Act as an independent agency of the District of Columbia government. The Agency has exclusive authority and discretion to manage the assets of the District of Columbia Teachers' Retirement Fund and the District of Columbia Police Officers and Fire Fighters' Retirement Fund (collectively referred to as the "Fund").

DCRB invests and manages the Fund, which is held in trust for the exclusive benefit of all members and their eligible survivors and beneficiaries. The assets of the Fund, which are commingled for investment purposes, can only be used to pay benefits and provide trust services to our members from their date of initial participation in the District of Columbia Teachers' Retirement Plan and the District of Columbia Police Officers and Firefighters' Retirement Plan (collectively referred to as the "Plans") throughout their lifetime and the lifetime of their survivors.

DCRB's Board of Trustees (the "Board") has 12 members, six (6) who are elected by members of the Plans, three (3) who are appointed by the Mayor, and three (3) who are appointed by this Council. In addition, the District's Deputy Chief Financial Officer (CFO)/Treasurer serves on the Board as an ex-officio (non-voting) member (representing the District's CFO). Board members are fiduciaries, who are required to discharge their responsibilities solely in the interest of Plan members and beneficiaries.

The District government, as the employer, is the Plan Sponsor and is responsible for the design of the Plans and for paying the required employer contributions to the Fund. DCRB, as Plan Administrator, is responsible for investing the assets of the Fund and for providing a range of pension administration services to our members. DCRB also serves as the third-party administrator for benefits under the federal plans for District police officers, firefighters, and teachers, which were frozen in 1997 and for which the U.S. Department of the Treasury ("Treasury") is financially responsible.

As of September 30, 2015, there were 24,394 members in the frozen federal and active District Plans, 16,730 of which are funded by the District. Of this number, 6,327 were retirees and survivors who receive monthly pension payments and 10,403 were active employees. The remaining 7,664 participants are federal retirees.

I am pleased to report that as of October 1, 2015, the Plans' aggregate funded ratio on an actuarial basis (the basis on which we report) was 101.7 percent. For the individual Plans, the ratios were 88.7 percent for the Teachers' Plan, and 107.6 percent for the Police and Firefighters' Plan. As of December 31, 2015, the market value of the Fund was $6.4 billion.

DCRB'S STRATEGIC GOALS

I would like to highlight our strategic goals, and outline how our current and upcoming initiatives are aligned with our budget for FY 2017 and beyond.

1. Safeguard the integrity of the Fund.

During Fiscal Year 2015, we engaged an independent actuarial firm to perform an actuarial audit. This audit provided an additional "set of eyes" and technical expertise to review our independent actuary's assumptions and calculations. We are pleased to report that the audit resulted in a finding that the assumptions, methods, and certifications used in the annual actuarial valuations are generally sound and reasonable, and that they conform to the appropriate Actuarial

Standards of Practice. Further, based on the samples tested, the audit found no reason to question the reliability of valuation results.

Also, as with other organizations, cyber-security threats continue to be of concern to DCRB's operations and could pose a serious challenge to our Agency. Mitigating these risks has been a focus of the Agency, and DCRB has invested in cyber-security insurance, and updated our security policies to ensure compliance with industry best practices, reducing our cyber-risk exposure. In addition, during FY 2016, DCRB will contract with an incident response vendor to assist the Agency if a cyber-security event were to occur.

2. Prudently invest Fund assets to provide long-term sustainable risk adjusted returns.

DCRB's ongoing objective is to prudently manage Fund assets with the goal of earning a return that meets or exceeds the actuarial investment return target of 6.5% over the long-term. The performance of the investment managers is measured against the return of their style benchmarks, and investment costs are compared to our industry peers of similar asset size and allocation. In addition, we frequently evaluate potential rebalancing opportunities within the Fund to ensure that the various asset classes are within our strategic target ranges.

DCRB conducted a search during FY 2015 that resulted in our transition to a new custodial bank, producing a savings of $300,000 over the next three (3) years. This year, we will conclude a search for an investment consultant, and we will work with that consultant to review the Fund's asset allocation and investment manager structure. Also, during Fiscal Year 2016, DCRB will conduct an asset-liability study to assure the continued alignment of the Board's asset allocation policy with its long-term liability structure.

3. Expand and improve member benefits administration capabilities while assuring benefits are paid to our members timely and accurately.

In FY 2013, DCRB launched a multi-year, Retirement Modernization Program focused on the areas of benefits administration and information technology. The Program included three main projects: Business Process Reengineering, Data Reclamation, and a Pension Information Management System ("PIMS"). Business Process Reengineering and Data Reclamation were completed last year. Later this year, we expect to release a Request for Proposal for the PIMS.

4. Refine DCRB's organizational structure to meet agency responsibilities and needs.

The Agency will continue to provide annual training for staff and Trustees, as well as ensure awareness of Personally Identifiable Information (PII) policies by all staff and contractors. During FY 2016, DCRB will also identify performance gaps and training needs and fill key staff vacancies, as needed.

Our primary focus over the next few years will be to transform our pension operations that currently are substantially manual and paper-based to an automated, digital environment that facilitates self-service and the production of benefit statements and other services accurately, timely and more efficiently.

5. Foster member and stakeholder trust through enhanced communications and collaborative outreach.

During FY 2015, DCRB enhanced staff efficiency by implementing intranet capabilities (an "employee portal") that encourages and facilitates collaboration through improved staff communication and information sharing. The employee portal has enabled DCRB to become a more technologically secure information-sharing organization. The portal is also designed to allow authorized staff to access information remotely in the event of a disaster.

During FY 2015, DCRB added a special Teachers' Edition newsletter that was published over the summer, when many teachers consider retirement. In FY 2016, DCRB published a special Police/Fire Edition newsletter for public safety officers. The focus of these newsletters is to provide information about retirement benefits and to encourage retirement planning. DCRB distributes newsletters to our members via e-mail and in hard copy.

In addition, in March 2015, DCRB joined with DCPS and the Washington Teachers' Union to offer teachers a retirement workshop, which was hosted at DCRB. A similar workshop, with substantially increased participation, was held in our building on March 23, 2016. We will continue working with DCPS, and with the Metropolitan Police Department and the District's Fire and Emergency

Medical Services Department, to identify opportunities like this that benefit members of the Plans.

In late FY 2015, DCRB initiated a “Benefits Community of Interest” group, which includes human resources personnel from stakeholder District agencies. The group met in October 2015, and plans to meet periodically to discuss subjects and issues of mutual interest. This group will be of special importance as DCRB moves forward with the Retirement Modernization Program.

DCRB’S 2017 OPERATING BUDGET

Now I will discuss our proposed FY 2017 operating budget.

DCRB manages the Fund, receives contributions from the District and employees, and calculates and pays benefits for eligible members upon retirement, termination, disability, or death.

In addition, as mentioned earlier, DCRB serves as the third-party benefits administrator for the frozen federal plans, receiving a payment from U.S. Treasury for these administrative services. That payment is anticipated to be $3.2 million for FY 2016 and $3.5 million for FY 2017.

Under the line item, Agency Management, DCRB’s FY 2017 budget reflects the following seven budgetary activities under the Executive Director’s oversight: Investments, Benefits, Operations (which includes Finance), Information Technology, Legal, Projects and the Executive Office (which includes the Communications and Outreach function). An eighth budgetary activity is under the Board of Trustees.

DCRB’s FY 2016 budget is $32.3 million. As we indicated during our budget testimony last year, with the retirement modernization projects now accelerating, we anticipate increases in our budget over the next few years.

DCRB’s FY 2017 budget is $39.1 million. The budget includes 69.6 authorized full-time employees (FTEs), an increase of 7.0 FTEs from the FY 2016 level. As in the past, we will continue to fill positions, as needed, for the prudent management of operations.

The proposed budget for FY 2017 includes the following:

- The Personal Services budget is $9.2 million, reflecting an increase of approximately $1.1 million over the FY 2016 amount. The increase includes an overall addition of 7.0 FTEs: four (4) in the Benefits Department to provide benefits administration and customer support services; two (2) in the Information Technology Department to manage systems that support the Retirement Modernization Program, and one (1) in the Legal Department to assist with matters related to Retirement Modernization and to provide expertise and support that ensures compliance across the Agency.

- The Non-Personal Services budget is $29.9 million, reflecting an increase of $5.7 million from the FY 2016 amount. This increase is related to our ongoing Retirement Modernization Program, which will ultimately result in DCRB's ability to pay initial pension benefits quicker, and to provide members with a full range of retirement services.

- On a line-item basis, DCRB's FY 2017 Budget varies from FY 2016 across the following Comptroller Source Groups (CSG):

  <u>CSG 11 Regular Pay- Continuing Full-Time</u>: An increase of $847,000 for the cost-to-continue operations, as well as the additional PIMS-related staff mentioned above. As we move ahead with the implementation of our strategic plan of enhanced services and technology improvements, DCRB will need to increase staffing levels.

  <u>CSG 14 Fringe Benefits</u>: An increase of $220,000 for projected fringe benefit costs related to CSG 11 Regular Pay.

  <u>CSG 20 Supplies and Materials</u>: A net decrease of $5,000 based on estimates derived from recent actual expenditures.

  <u>CSG 31 Rent</u>: A decrease of $18,000 to reflect the lease expenses we are incurring.

  <u>CSG 40 Other Services and Charges</u>, and <u>CSG 41 Contractual Services</u>: An increase of $5.6 million largely related to the PIMS. This includes

preliminary systems, such as, an Enterprise Data Quality tool and a Master Data Management system that will allow DCRB to collect Plan member information from the District's PeopleSoft active member repository and from U.S. Treasury's electronic annuitant system, and to aggregate the information in a database that will become a single source for maintaining the Plans.

As already noted, the PIMS will not only allow DCRB to calculate and pay benefits, but also to reduce our reliance on paper documents, and minimize the turnaround time to deliver initial pension payments.

CSG 70 Equipment and Machinery: An increase of $120,000 reflects the need for software and hardware for the implementation of the systems indicated above.

THE DISTRICT'S NORMAL CONTRIBUTION

The Plans' actuary has estimated that the District's certified Normal Contribution for FY 2017 is $202.4 million. As a general rule, employer contributions for all groups rise as salaries increase, assuming other actuarial assumptions are met. The key drivers that can change the annual contribution include the recognition of investment gains or losses, wage and general inflation, differences in assumed versus actual retirement and mortality rates, as well as changes due to labor contract negotiations and legislation. As I mentioned, our independent actuary is here to answer any questions you may have on DCRB's contribution rates and funding status.

In summary, I am pleased to report that the Fund is in excellent shape. Our Board has maintained conservative investment assumptions, the Plan is in sound financial condition, and we pay members timely. We have a skilled Board and an experienced team managing our strategic initiatives. And, most importantly, we continue to make strides toward creating a comprehensive retirement system to serve the needs of our members.

In closing, I'd like to thank the Committee for your continued support in helping us to carry out this mission. As we proceed, we may seek your assistance in helping us accomplish our goals. We look forward to working with you and your staff.

This concludes DCRB's Budget Oversight Hearing Testimony. We look forward to answering your questions.   Thank you.