PERFORMANCE OVERSIGHT HEARING ON THE DISTRICT OF COLUMBIA RETIREMENT BOARD FOR FISCAL YEAR 2018

Testimony of

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Before the

Honorable Phil Mendelson, Chairman
Committee of the Whole
Council of the District of Columbia

John A. Wilson Building, Room 123
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OPENING REMARKS

Good afternoon Chairman Mendelson and members of the Committee of the Whole. I am Sheila Morgan-Johnson, Executive Director of the District of Columbia Retirement Board (DCRB or the Board). I am pleased to testify on DCRB's FY 2018 performance. With me today to also respond to the Committee's questions are Ed Koebel of Cavanaugh Macdonald Consulting, our independent actuary and members of DCRB's senior staff. Before discussing the mission and priorities of DCRB, I would like to acknowledge the guidance and support provided by our Board of Trustees and the assistance of this Committee and your staff over the past year.

OUR HISTORY AND MISSION

DCRB was created by Congress in 1979 as an independent agency of the District of Columbia Government. The Board is a fiduciary that has the 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). These assets are held in trust for the sole benefit of members of the District of Columbia Police Officers and Firefighters' Retirement Plan and the District of Columbia Teachers' Retirement Plan (referred to as the Plans), as well as their eligible survivors and beneficiaries.

The District is responsible for members covered under the District Replacement Plans (the District Plans), which were adopted on July 1, 1997. Fund assets, which are pooled for investment purposes, may only be used to pay benefits and expenses necessary to administer the retirement program. DCRB also serves as the third-party administrator for benefits earned through June 30, 1997, under the frozen plans (the Frozen Plans), which are the responsibility of the U.S. Department of the Treasury (U.S. Treasury). U.S. Treasury reimburses DCRB for costs we incur for these third-party administrator services. Any reimbursement of administrative expenses from U.S. Treasury offsets the amount required from the Fund each year.

For the District Plans, the District Government, as the employer, is the Plan Sponsor, and is responsible for the design of the Plans, for certain benefits administration activities, and for paying the required employer contributions into the Fund. In addition to employer contributions, Fund income includes employee contributions, which are a fixed percentage of their pay, and investment earnings.

DCRB's mission consists of the following two overarching goals: (1) to prudently invest and manage the assets of the Fund, and (2) to administer retirement benefits by providing members with accurate and timely pension payments, as well as excellent customer service. Agency operations are managed in accordance with our fiduciary responsibilities and relevant legal authorities. The projects and initiatives in progress and planned for the future are undertaken to support this mission.

STATUS OF THE FUND AND THE PLANS

As of September 30, 2018, the total membership of the District Plans and the Frozen Plans was 26,431. It should be noted that approximately 74 percent (19,590) of those members are now covered under the District Plans and/or jointly funded by the District and federal governments. Although the current majority of benefit payments are paid by U.S. Treasury for accrued federal benefits, the District is becoming responsible for an increasing portion of the total benefits.

Last year, Cavanaugh Macdonald performed a Thirty-Year Projection Study (Study), the purpose of which was to determine funding requirements by estimating the future assets, liabilities, contributions and benefit payments for each of the Plans over time. The Study also serves as a guide for investment decisions. The Study projected that District payments to annuitants are expected to surpass those of the U.S. Treasury around 2031, just twelve years from now.

The Board's Actuarial Valuation Report for Fiscal Year (FY) 2018 indicates that the aggregate funded ratio for the District Plans was 106.2 percent (up from 105.2 percent in FY 2017). The individual Plan ratios were: 93.0 percent for the Teachers' Plan and 112.0 percent for the Police Officers and Firefighters' Plan. Separately, the ratios are 113.7 percent for Police Officers and 108.2 percent for Firefighters.

At a prior Investment Committee meeting, the District's Chief Financial Officer, Jeffrey DeWitt, advised Trustees and senior management that the Plans' strong funded status is having a positive impact on the District's bond rating, and complimented the Board on its proactive approach with regard to the Projection Study for long-term planning purposes. It is also important to note that the Center for State and Local Government Excellence reported that in 2016, only four (4) public plans (including the District's Police/Fire Plan) were funded at 100% or higher. In addition, as of June 30, 2018, the aggregate funded ratio of the nation's largest public pension plans was 72.1 percent.

As of September 30, 2018, the Fund was valued at $8.2 billion, an increase of approximately $445 million in total asset value over the previous twelve months. Since the close of the fiscal year, the equity markets have been quite volatile. For example, the Russell 3000 Index was down 14.3 percent, and the MSCI EAFE Index fell by 12.5 percent during the first quarter of FY 2019. As a result, the value of the Fund declined to $7.8 billion by year-end. With the equity market rally in January, however, the value of the Fund was back to $8.2 billion as of January 31, 2019.

OUR GOALS

Prudently Invest and Manage Fund Assets

One of DCRB's major ongoing responsibilities is to prudently invest Fund assets, with the goal of earning a return that meets or exceeds our actuarial investment return assumption of 6.5 percent. This target is intended to sustain the Fund's viability over the long-term investment horizon. I am pleased to report that as of September 30, 2018, the Fund generated an annualized gross return of 8.8 percent since its inception in October 1982, surpassing the 6.5 percent long-term actuarial return target. For FY 2018, a volatile year for the market, the Fund earned a gross return of 5.4 percent.

In building a solid foundation for achieving long-term, sustainable risk-adjusted net returns, we routinely review investment manager performance against benchmark returns, rebalance the portfolio to maintain compliance with asset allocation targets and ranges, and monitor and evaluate fees. In addition to systematically reviewing the investment performance and operational processes of investment service providers, DCRB completed the following investment activities in FY 2018:

- Analyzed different negative market return scenarios. DCRB's investment consultant provided Trustees with an illustration of how the performance of the Fund's current asset allocation could be impacted by a decline in the valuation of U.S. equity securities, and a reallocation of those assets to high-quality fixed-income securities to avoid extreme equity losses.

- Offered continuing education to Trustees and Staff on fiduciary responsibilities, ethics, risk management and mitigation strategies, the private markets' legal process, cybersecurity awareness, agricultural and private credit education, and overall investment compliance.

The integration of a strong governance, risk, and compliance program is critical to sustaining longer-term investment returns. During FY 2019, DCRB will enhance our formal assessment of operational risks to identify, manage, and mitigate non-market risks. We will accomplish this by focusing on business, legal, and operational risks as core factors for committing capital to new investment managers and as part of ongoing monitoring efforts.

We will further validate the accuracy of fees paid to our investment managers to ensure compliance with investment agreements. This is a key initiative of the U.S. Securities and Exchange Commission. In addition, the Board is reviewing with our investment consultant various asset class mixes that are forecasted to achieve the long-term target return within acceptable risk parameters.

Finally, during FY 2019, DCRB will engage a consultant to conduct an operational fiduciary audit. This is a top-to-bottom analysis of the Agency's operations, processes and performance needed to ensure that DCRB is following best practices and planning for Fund sustainability as the District contribution increases and we are serving more District-funded members without a federal reimbursement.

Provide Members with Accurate and Timely Payments and Excellent Customer Service

Another of DCRB's major responsibilities is to administer retirement benefits. Among our primary tasks is to ensure the accurate and timely payment of benefits to retired Plan members and their survivors and beneficiaries, and to provide them with excellent customer service. These services include providing members with information about the Plans, responding to their questions, and keeping them aware of changes and issues related to their benefits.

Annual Benefits Statements

During FY 2018, DCRB provided annual Estimated Benefits Statements (Statements) to all active members of the Plans. We expect to issue 2019 Statements in the fall of this year.

Member Focused Communications
During FY 2017, DCRB completed a benchmarking project to determine how our benefits administration operations compared with best practices and to other public pension systems of our size. The results revealed that DCRB significantly lags its peers in the adoption of member focused technology. For example, DCRB currently lacks an annuitant self-service website portal, where members can update their personal information and receive timely and targeted communications. During FY 2018, we began discussions with U.S. Treasury and the District's Office of the Chief Technology Officer (OCTO) to explore the development of an online self-service application that will allow annuitants to access their benefit and tax-related information.

Other Retirement Modernization Efforts
During FY 2018, DCRB completed an audit of its Information Technology (IT) operations and internal systems to ensure that proper safeguards are in place to protect the Fund, and that our IT footprint is consistent with the needs of the Agency. The audit resulted in changes to the structure and focus of that department. We also leveraged District resources, in the form of services provided by OCTO, and replaced our telephone system using District services, which resulted in enhancements to our customer service capabilities and cost savings to DCRB. Our strategy is to position the IT Department to focus more on service delivery that will help members, operate more efficiently, using a combination of internal staff and OCTO services for specific, targeted projects. To save time and costs, we will continue to seek opportunities to leverage services provided by OCTO to: help us assess the data management system, assist with the relocation and modernization of the network, and enhance our pension operations.

Legislative and Compliance Initiatives

2017 Summary Plan Descriptions
In early 2018, DCRB distributed updated Summary Plan Descriptions (SPDs) for each of the Plans to all Plan members. The new SPDs clarify Plan provisions, benefits administration policies and processes, and summarize the provisions of the Plans in a format that is easier to read and understand.

Technical Amendments to the District Plans
In late September 2017, the Teachers, Police, and Firefighters Retirement Benefits Technical Amendment Act of 2017 was introduced by the Council. This legislation is currently undergoing Congressional review and is expected to become law later this month. We appreciate the assistance of the Council in moving this legislation forward.

Strategic Planning and Initiatives

Last year, in my first year as Executive Director, I set the course for DCRB's continued advancement under my leadership with a re-evaluation of the Agency's current goals and objectives to ensure that they continue to align with DCRB's mission. As a part of that process, DCRB began a Strategic Planning Project in August 2018 that involves the Board and all DCRB employees.

In tandem with the Strategic Planning Project, and in preparation for the eventual acquisition of a pension management information system, we are refocusing our efforts on reviewing, analyzing, and documenting the major processes that are a part of our benefits administration operations. The purpose of this project is to update processes that were adopted several years ago in a paper environment, assure alignment with the processes of our partner agencies, document process steps from end-to-end, and eliminate or adjust antiquated activities prior to memorializing the processes in a new system.

Other Initiatives

In addition to the initiatives already noted, we will continue to partner with District agencies in other areas, such as the District of Columbia Human Resources Department for training and the Office of Contracts and Procurement for procurement assistance.

CONCLUSION

In summary, I am pleased to report that the Fund is in sound financial condition and that we continue striving to pay our Plan members accurately and timely. Further, the Trustees are engaged and committed to our mission, and we have a knowledgeable and experienced senior management team leading the Agency's strategic initiatives. Together, we continue to move forward in creating a comprehensive retirement system to serve the needs of Plan participants over the long-term.

In closing, I would like to thank you for your support, the Board for its guidance, and the DCRB staff for their hard work. I am happy to answer any questions you may have.

This concludes my testimony.