



Defined Benefit Plan Analysis

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**Asset
Strategies**
Portfolio Services, Inc.

Independent, Professional Investment Consultants Since 1992.

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Introduction	2
Purpose of the Analysis	5
Key Findings	8
Recommendations	22
About This Report	28
Addendum-Exhibit 13 _(rev.)	30



George Vitta

EXPERIENCE

- 32 years: financial services industry
- 26 years: investment consultant
- 1992, founded Asset Strategies Portfolio Services
- Trustee and Officer of various foundations
- Registered Investment Advisor Representative
- 25 year member of MAPERS
- Created the first quarterly Michigan public fund investment performance universe
- Speaker, author, advisor to MAPERS Board of Directors and state legislative advisor.



EDUCATION

- B.A., Economics, University of Michigan
- M.B.A., Finance, Wayne State University
- Post-graduate training in:
 - Actuarial science
 - Benefit plan design
 - Benefit plan administration

Katherine Ghannam, CPA

EXPERIENCE

- 31 years; financial services and accounting
- 21 years; investment management and consulting
- Registered Investment Advisor Representative
- Four year member of MAPERS
- Featured Speaker and author for MAPERS
- Named fiduciary at Mars, Inc., (the candy company) as investment manager of the corporate retirement plans and cash management investments
- Served as Director of Institutional Consulting for a Michigan based insurance company



EDUCATION

- B.S., Accounting, University of Maryland
- M.B.A., Finance, The Pennsylvania State University
- C.P.A., Washington, D.C. #3095

Purpose of the Analysis

Asset Strategies Portfolio Services was selected by a panel comprised of both County Commissioners and Board Members of the Monroe County Employees Retirement System to perform a detailed professional analysis of the Monroe County Employees Retirement System Defined Benefit Plan, hereafter referred to as “MCERS”.

Scope of Services

- 1) Analyze the historical returns of the assets, and compare the returns to similar Michigan Public Act 314 governed Retirement Systems of similar asset size and demographics. The analysis shall include a review of cash flows, asset allocation, and manager performance over the most recent 15-year historical period.
- 2) Calculate asset weighted fees versus alternate managers or peer groups
- 3) Performance comparison gross-of-fees (GoF) and net-of-fees (NoF).
- 4) Compare investment consulting and money manager fees versus alternative managers or peers
- 5) Compare MCERS travel budget with other public plans.
- 6) Plan Administration and staffing breakdown with costs comparison.

Michigan County Plans Participating

County Plan	12/31/2013 \$MV	Funded Status (as of 4Q12)	Actuary Rate	Plan Status
Bay	\$ 295,503,588	105%	7.5%	Closed
Macomb	\$ 907,346,000	101%	7.5%	Closed
Oakland	\$ 800,084,000	100% (3Q13)	7.25%	Closed
Kent	\$ 757,005,057	97%	7.0%	Open
Midland	\$ 55,047,402	90%	7.5%	Closed
St Clair	\$ 218,758,173	82%	7.5%	Closed
Monroe	\$ 189,403,009	79%	7.0%	Partial Close
Jackson	\$ 144,151,959	76%	7.5%	Open
Genesee	\$ 443,638,758	75%	8.0%	Partial Close
Berrien	\$ 163,203,528	69% (4Q13)	8.0%	Open
Washtenaw	\$ 245,896,945	59%	7.25%	Open



MONROE COUNTY

Key Findings



MCERS Financial Profile

Year	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Funded Status	76.6%	79.3%	79.7%	83.2%	89.3%	92.5%	97.0%	97.3%	99.7%	108.1%	116.9%
Investment/Gains*	\$20.4	\$14.6	(\$3.6)	\$15.8	\$21.2	(\$35.9)	\$13.7	\$18.3	\$12.5	\$11.8	\$19.3
Contr./Employer*	\$7.2	\$7.2	\$6.0	\$5.9	\$5.5	\$5.4	\$4.9	\$3.2	\$2.0	\$1.4	\$0.2
Contr./Employee*	\$0.7	\$0.7	\$0.6	\$1.8	\$0.2	\$0.2	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3
Payments*	\$14.1	\$13.6	\$13.5	\$12.5	\$10.0	\$8.7	\$8.7	\$7.6	\$7.2	\$6.4	\$5.8
Net Plan Assets*	\$189.6	\$175.3	\$166.3	\$176.7	\$165.6	\$148.8	\$187.8	\$177.5	\$163.3	\$155.5	\$148.4

*\$ in millions. Data is from the audited financial statements and Actuarial Reports

Investment Results

Observations

- MCERS' investment results consistently underperform the investment objective ('Policy Index') established by the consultant.
- Longer-term results fail to meet the 7.0% actuarial rate of return assumption

Plan Peer Group Rankings

Observations

- 1) MCERS' investment results consistently rank in the bottom quartile (lowest 25%) among the peer group of public employee pension plans.
- 2) The low peer group rankings might be explained by the asset allocation of MCERS versus the typical public pension plans' allocation.

Plan Net Of Fee Results

Observations

- 1) MCERS' NoF results were also evaluated.
- 2) For all time periods (1-, 2-, 3-, 5-, 7-, 10-, and 15-years periods), MCERS net-of-fee results ranked in the bottom quartile of the peer group.

Investment Manager Results

Observations

- 1) Performance of existing plan managers (as of 12/31/2013) is summarized in the MCERS 2013 Performance Report.
- 2) All current U.S. equity managers underperformed their benchmark index for the trailing 5-year period.
- 3) Two of the four U.S. equity managers, both retained for more than 10 years, underperformed their benchmark for the trailing 5-year period and rank poorly among their peer group.
- 4) Two of the four international equity managers, underperformed for the trailing 5-year period and rank poorly among their peer group.
- 5) Manager turnover (firing then replacing) is high. 15 managers in 15 years.

Investment Manager Fees

Observations

- 1) Investment Manager fees are paid by the plan to the investment manager of each portfolio
- 2) There are 6 different classes of money managers. Fees paid to 5 out of 6 are average or just below average
- 3) Just one class of manager fees are above average

Consultant Fees Comparison

County Plan	12/31/2013 \$MV	Total Consulting Fee (2013)	
		\$amount	basis points
Monroe	\$ 189,403,009	\$214,657	12 ¹
Bay	\$ 295,503,588	\$140,000	4.7
Berrien	\$ 163,203,528	\$50,000	3.1
Genesee	\$ 443,638,758	\$148,860	3.4
Jackson	\$ 144,151,959	\$56,250	3.9
Kent	\$ 757,005,057	n/a	n/a
Macomb	\$ 907,346,000	\$200,000	2.2 ²
Midland	\$ 55,047,402	\$32,000	5.8
Oakland	\$ 800,084,000	\$240,000	3.0 ²
St Clair	\$ 218,758,173	\$74,304	3.4
Washtenaw	\$ 245,896,945	\$80,000	3.3

* Consulting Fees for Kent County were unavailable

* Berrien's 2013 calculated bps fee is based on actual 2012 consulting fees

Consultant Fees Paid By MCERS

Monroe	Avg \$MV for ³ Calendar Year	Total Consulting Fee (by Year)	
		\$amount	basis points
2012	\$ 173,332,272	\$225,332	13.0
2011	\$ 169,750,142	\$254,625	15.0
2010	\$ 167,040,488	\$250,561	15.0
2009	\$ 153,129,417	\$229,694	15.0

1) **Morgan Stanley (MS) Consulting Fee Schedule:**

15 bps pre Sept 2012; 10 bps Sept 2012 thru April 2013; **12 bps thereafter.**
 MS disclosed to the Committee on 9/25/2014 that their 'true consulting' fee is 7 bps, while the above number contains non-consulting services.

2) **estimated using meeting records and Interviews**

3) **Average \$MV calculated using quarter-end \$MVs provided by Morgan Stanley**

Travel Budget Summary

Observations

- 1) A comparison of MCERS' travel budget and expenditures versus three other Michigan county plans is provided.
- 2) Amendments to PA Act 314, enacted under PA 347 of 2012, effective April 2013, requires adoption of an annual training and education budget.
- 3) Under the statute, travel is capped at the lessor of \$150,000 or an amount equal to \$12,000 multiplied by the number of board members, not to exceed \$30,000 for any one board member.
- 4) The Monroe County Board of Commissioners passed a reduction in the travel budget from 2012 to 2013. This policy limits total travel costs to \$30,000 per year and \$3,000 per trustee, a sharp reduction from prior years.

Plan Administration Summary

Observations

- 1) A “Comparison of Plan Administration and Costs” for various County plans is provided. The size of the plan, the number of active and retired participants impact the level of work involved.
- 2) Staffing is also affected by the level of services provided. For example, many plans outsource their retiree payment services, while Washtenaw County processes retiree checks in house.
- 3) County plans with full time administrators, may have additional responsibilities including administration of a Retiree Health Care or Defined Contribution Plan.
- 4) “Supervising Department”. MCERS has one Retirement Administrator, who reports directly to the Retirement Board Chairperson.
- 5) Many County plans’ administrators report directly to Human Resources, with costs allocated based on work directly related to the retirement plan.

MCERS Financial Profile

Year	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Funded Status	76.6%	79.3%	79.7%	83.2%	89.3%	92.5%	97.0%	97.3%	99.7%	108.1%	116.9%
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Contr./Employer*	\$7.2	\$7.2	\$6.0	\$5.9	\$5.5	\$5.4	\$4.9	\$3.2	\$2.0	\$1.4	\$0.2
Contr./Employee*	\$0.7	\$0.7	\$0.6	\$1.8	\$0.2	\$0.2	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3
Payments*	\$14.1	\$13.6	\$13.5	\$12.5	\$10.0	\$8.7	\$8.7	\$7.6	\$7.2	\$6.4	\$5.8
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*\$ in millions. Data is from the audited financial statements and Actuarial Reports

Concluding Observations

- 1) Investment results, demographics, and benefit promises, are some key drivers of the deterioration in funded status, which has fallen from 116.9% in 2003 to 76.6% at the end of 2013.
- 2) A reduction in the actuarial return assumption in 2003, from 7.5% to 7.0%, contributed to a reduction in the funded status from 116.9% to 108.1% and increased employer contributions from \$191,979 in 2003, to \$1,411, 037 in 2004.
- 3) Plan liquidity needs (benefit payments and expenses) are over \$14 million per year, and expected to increase each year. Funded status continued to drop due to poor investment results, especially in the last five years.

Concluding Observations (cont.)

- 4) The County continues to fund the annual required contribution, however, poor investment results and changing demographics continue to impact the Plan's financial health.
- 5) Employer contributions continued to increase and rose to \$7.2 million in 2012.



MONROE COUNTY

Recommendations



Investment Policy/Asset Allocation

- ✓ The Investment Policy must be re-worked for long-term, consistent, risk-adjusted results. The Board of Trustees is responsible, in conjunction with the actuary and investment consultant.
- ✓ Review the investment policy and objectives with your Actuary. Discuss their assumptions, concerns, future contributions, other sources of funding risk, liquidity needs, and expected change in funded status, if investment results don't improve.
- ✓ Determine the risk tolerance of the Board relative to the required rate-of-return. While some regard 'risk' as losing investment principal/capital, there is also the risk of not attaining the asset growth necessary to meet the Plan's growing liabilities. The appropriate trade-off can be measured and addressed.

Cash Flow and Liquidity Needs

- ✓ Ask your consultant to evaluate the asset allocation policy relative to the Plan's financial condition, liability horizon, asset growth and liquidity needs, and recommend investment policy changes.

Manager Roles & Performance

- ✓ Have the consultant justify the high turnover of investment managers (15 changes) over the past 15 years.
- ✓ Have the consultant explain the ‘disconnects’ and inconsistency in their performance reporting.
- ✓ Have the consultant explain why investment management fees are lower than average. Then, ask them to explain why the managers’ performance is also below average.

Consultant Fees

- ▶ Consulting fees, at 12 basis points (0.12% times \$189.4 million = \$227,280), are the highest among the 11 Counties responding. The Board should address this significant disparity.

Consultant's response to the Committee's request for fee disclosures was 7 basis points for advisory-only services. This causes confusion because Morgan Stanley charged the plan 15 basis points (25% more) through September 2012, and then suddenly reduced the fee to 10 basis points for a period of 8 months. Then the fee jumped (20%), back to the 12 basis points of today.

- ▶ The consultant states the fee includes “other services”, which is the 5 basis points higher cost between their current 12 basis points and the advisory-only fee of 7 basis points. It appears the Plan might be due a refund from Morgan Stanley because it was charged for services they did not deliver.

Especially Important!

Review the asset allocation policy whenever a significant change occurs. Changes in asset classes, investment managers, liabilities, liquidity needs, or statutory requirements, such as the 2012 amendment to Michigan Public Act 314 of 1965, are all proper reasons to conduct an asset allocation study.

About this Report

Asset Strategies Portfolio Services, Inc., an independent, investment advisory firm, was hired to perform a professional analysis of the Monroe County Retirement System. Data received for this analysis was obtained from multiple sources as noted below. Asset Strategies does not warrant the accuracy of data provided to us by others, but has attempted to obtain and utilize reliable information.

MCERS Data

1. Morgan Stanley, investment consultant for MCERS, for the past 15 years, provided the Total Plan historical data for MCERS from 1998 to 2013 and included the following:
 - a. Quarterly Plan returns were provided gross-of-fees (GoF). Net-of-fees (NoF) numbers were provided, but not used in this report because the data was deemed unreliable.
 - a. Quarterly Total Plan market values and net cash flows
 - b. Manager cash flow history, fee schedules, length of service, existing and terminated managers from 1999 through the first quarter of 2014.
 - c. Benchmarks for each manager
 - d. Quarterly Manager (GoF) results and quarterly market values
 - e. Total Plan Policy index for each year
2. MCERS Audited Financial Statements – Rehmann Robson, Certified Public Accountant Reports, 2003 through 2012
3. MCERS Actuarial Reports – Gabriel Roeder Smith & Company Reports for 2013 and prior years back to 2003
4. Board minutes and other data as provided on the MCERS web site
5. Data provided by the MCERS' plan administrator

Other Michigan County Plans' Information

Data was obtained from multiple sources as noted below:

1. Plan administrators, consultants, and others;
2. County websites; including meeting minutes;
3. Audited financial statements;
4. Actuarial reports



About This Report (cont.)

We did not audit the data, Data obtained was checked for internal and year-to-year consistency. We are not responsible for the accuracy or completeness of the information provided by Monroe County, or any other entity providing data for this report. Do not rely on this report for any purpose of than the purpose described in the primary communication.

This report contains analysis of the total fund and individual managers' performance. The returns calculated by investment managers will occasionally differ (albeit slightly) from the returns calculated by Asset Strategies. Differences may be explained by any one or a combination of the following factors:

- a. managers account for securities purchases, sales, and cash flows on a mid-month basis, while Asset Strategies accounts for transactions on the date of occurrence,
- b. the pricing sources used by the managers are different from the sources used by the custodian,
- c. managers report purchases and sales on a trade date basis, while custodial banks generally report on a settlement date basis, and
- d. managers and custodians differ in their method and timing in accounting for accrued income.

Investment results for periods greater than one year are annualized and gross-of-fees.

The Registered Investment Advisor firm publishing this report is independent of the plan sponsor, Monroe County Board of Commissioners, actuary, auditor, investment managers and investment consultant referred to in this report.



Independent, Professional Investment Consultants Since 1992

Addendum

CORRECTED 10/6/14 Comparison of Plan Administration and Costs

County Plan	12/31/2013 Market Value	Plan Administration Staff	Administration Budget	Supervising Department	Number of Plan Beneficiaries	
					Active	Retired/other
Monroe	\$ 189,403,009	1.0	\$60,000	County Library/Reports to Retirement System Chairperson as needed	700 268***	888 162***
Bay	\$ 295,503,588	1.5	N/A	Human Resources	1172	876
Berrien	\$ 163,203,528	*	N/A	County Administrator	834	655
Genesee	\$ 443,638,758	2.0	\$140,000	Controller	793	1657
Jackson	\$ 144,151,959	1.75	N/A	Human Resources	307	801
Kent	\$ 757,005,057	2.0	\$136,000	Human Resources	1605	1417
Macomb	\$ 907,346,000	2.5	N/A	Human Resources	2079	2826
Midland	\$ 55,047,402	*	\$0	County Clerk	131	178
Oakland	\$ 800,084,000	1.0	\$85,000	Personnel Director	461	2083
St Clair	\$ 218,758,173	1.0	\$50,000	Human Resources	803	789
Washtenaw	\$ 245,896,945	2.5**	N/A	Human Resources	1020	939

* No dedicated full-time or part-time employees. Instead, plan administration duties are shared by various employees in different departments.

** Includes in-house payroll processing/accounting/administration

Employees work for HR and costs are allocated to the DB based on a recent time study

***Number in red has been updated to reflect the numbers reported in the 12/31/13 valuation by GRS, as shown in bla