Minutes of the DERP Retirement Board

July 21, 2023 - Meeting #852

Meeting #852 of the DERP Retirement Board was held at the Grant-Humphreys Mansion and via video/audio. The meeting began at 9:00 a.m. DERP Retirement Board Members present: Diane Barrett, Guadalupe Gutierrez-Vasquez, John Dominguez, and Lisa Ramirez. DERP Advisory Committee Members present: Heather Britton, Roberta Monaco, and Maro Casparian. DERP Staff present: Heather Darlington, Executive Director; Jake Huolihan, Finance and Operations Director; Roni Kirchhevel, Benefits and Membership Services Director; Julie Vlier, Marketing and Communications Director; Randall Baum, Chief Investment Officer; Pamela Watson, Deputy Chief Investment Officer; Ben Baugher, IT Manager; Nali Kande, Membership Services Representative; and James E. Thompson III, General Counsel. Others present: Anne Harper and Tim Hall from Cheiron.

1. The Minutes of Meetings #850 and #851 were approved by a unanimous vote of the retirement board members.

2. Anne Harper and Tim Hall from Cheiron presented the preliminary 01/01/23 actuarial valuation. Anne Harper began by noting the 2023 preliminary actuarial valuation results included the approved demographic assumption changes accepted at the May retirement board meeting. She touched on the key points of their presentation then turned the floor over to her colleague, Tim Hall.

   Tim Hall opened with an overview of DERP, providing statistics on active and inactive members, and different membership tiers. He went on to discuss the liabilities, assets, and funded status, detailing the calculation of what contributions are required to properly fund the trust. He noted that 96% of DERP's actuarial liability comes from the pension plan, with $1.28 billion from the active participants and $2.97 billion from inactive participants, for a total actuarial liability of $4.25 billion.

   Next, Mr. Hall discussed DERP's assets. He explained how the market value of assets (MVA) can fluctuate significantly from year to year with rapid changes in investment markets, and that a smoothed value, the actuarial value of assets (AVA), is used to reduce the volatility in the contributions and better understand trends in funded status. The return on the MVA was -9.2% during 2022, while the return on the AVA was 5.2%. Both exhibited losses since the returns were below the assumed rate of return of 7.25%.

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Mr. Hall then compared the liabilities to the assets, noting an unfunded actuarial liability (UAL) of $1.66 billion. As of January 1, 2023, the funded ratio based on the AVA was 60.9%, which was a slight decrease from last year's funded ratio of 61.2%. The funded ratio stayed relatively stable even with less than favorable asset returns. On a market value basis, which is also used in the plan's financial reporting, the 01/01/23 funded ratio based on the MVA is 56.4%, compared to last year's funded ratio of 65.8%. Mr. Hall explained that this is because there are deferred asset losses not yet reflected in the smoothed value of assets.

Anne Harper resumed her presentation by reviewing the actuarially determined contribution (ADC) as both a percentage of payroll and dollar amount. She explained that the first component of the ADC is the normal cost, or the cost for active members accruing their benefits for the year. She reported that the normal cost of DERP is 8.6%, which translates to $68.48 million dollars, excluding the DHHA supplemental normal cost payment of $0.42 million dollars. She explained that the next component of the ADC is the unfunded liability amortization payment, or the amount necessary to pay off the UAL over the period designated in DERP's funding policy. She reported that the amortization payment for the unfunded liability is 16.86% or $141.55 million dollars, which brings the total ADC to 25.02% or $210.03 million dollars. She further explained that the UAL rate can be split into the payment made to cover the interest on the UAL and a smaller payment towards the UAL principal. She noted the amount of UAL principal being paid off increased from 1.76% of payroll in 2022 to 2.50% of payroll in 2023, and the total ADC rate decreased by 1.38% of payroll for 2023.

Ms. Harper then reviewed historical data and trends. She reported that contributions were expected to exceed the normal cost, plus interest on the UAL, reducing the UAL, even though the payment for lowering the assumed rate of return to 7.25% was still being phased in. She also noted that assets returned less than expected, -9.2% on a market basis (net of investment and administrative expenses) and 5.2% on a smoothed basis, increasing the UAL and ADC. She also noted that liabilities were higher than expected, increasing the UAL, but that the impact on the ADC was offset by the continued decline in the normal cost caused by the increase in Tier 3 membership. Ms. Harper announced that payroll growth was extraordinary, almost 16% versus the 3.0% assumption, which resulted in more contributions being collected than anticipated and decreasing both the UAL and ADC. She explained that the UAL payment decreased as a percentage of payroll since the dollar payments were spread over a significantly larger payroll base. She summarized that more contributions and higher payroll decreased the ADC rate by 2.12%. She further noted that the demographic assumptions adopted at the May 2023 retirement board meeting also decreased the UAL and ADC. Most notable was the impact on of less optimistic improvements in mortality. She concluded by reminding the retirement board members that at its May 2023 meeting, it deferred discussion on adoption of a new assumed rate of return until the July 2023 meeting.

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Ms. Harper then discussed potentially lowering the actuarial assumed rate of return (ARR). She noted that the current 7.25% ARR remains reasonable, but higher than the national median of peers at 7%. She explained that reducing the return assumption increases the margin for conservatism, but lowering the ARR to 7.00% would increase the actuarial liability and UAL by about $110 million, with a corresponding decrease in the funded ratio from 60.9% to 59.4% (based on AVA). She noted both the normal cost and UAL payment would increase at a 7.00% ARR, and the total ADC would increase about 1.07% of payroll, or about $9 million based on projected payroll for 2023 of $840 million. She then explained that, even at a 7.00% ARR, the ADC for the 2023 valuation would still be lower than the current rate, by about 0.30% of payroll.

Heather Darlington clarified that DERP staff was seeking approval from the retirement board to make the recommendation to the city council to reduce the actuarial assumption of investment return. She explained that the recommendation from the retirement board would allow DERP staff to work through the process of introducing a bill to city council. The retirement board voted unanimously to recommend lowering the actuarial assumption of investment return from 7.25% to 7.00%.

3. Ben Baugher provided an IT update. Mr. Baugher reported the IT team has made progress on cyber security, including moving internal systems to the cloud, enabling the IT department to shut down all access to DERP's external firewalls. He also reported the results of penetration testing and on-site security testing. He informed the retirement board that the IT department is working on building next generation tools to stay ahead of evolving cyber security threats, including adding multiple tools to DERP's system and contracting third-party companies to proactively pursue outside threats. Ms. Darlington thanked Mr. Baugher for his update and working on multiple projects in a short amount of time.

4. Randall Baum provided an update on the investment consultant RFP. He reported the RFP had been sent to five firms, and the firms submitted questions to DERP, which were answered by DERP staff earlier in the week. He noted the next deadline will be August 3, 2023, when the proposals are due, with finalists selected by August 24, 2023. He explained that the evaluation process would take about a month, until the end of September, to submit a final recommendation and bring that recommendation to the retirement board meeting in October. He stated that Lisa Ramirez and John Dominguez had volunteered to travel for due diligence but noted that scheduling conflicts may make it difficult for either of them to make it to all the on-site visits and recommended designating a backup committee member. Guadalupe Gutierrez-Vasquez was identified as a backup in the event neither Ms. Ramirez nor Mr. Dominguez are available. Lisa Ramirez stated she would like to appoint the member of the retirement board who is able to make all on-site visits once the dates are confirmed.

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5. Heather Darlington presented the Strategic Plan Update. She reminded the retirement board that DERP's 2023-2027 Strategic Plan sets forth the goals and objectives to realize the future vision of success. She explained that, at the beginning of the year, DERP staff identified action items to address in 2023, identifying both short term and long-term goals. She reported progress on each of the goals, including the goals of ensuring long-term financial health, evolving education and service and upholding DERP's leadership position. She asked the retirement board for feedback on the progress and suggestions for prioritization of any particular action items. Lisa Ramirez, Guadalupe Gutierrez-Vasquez, Heather Britton, and Maro Casparian commended the DERP staff for progress made on the Strategic Plan.

6. Roni Kirchhevel presented the Annual Membership Overview. She presented high-level demographics and statistics for active and inactive members. She noted DERP has 9,576 active members, 3,714 inactive vested members, and 11,067 members receiving a monthly DERP Pension Benefit. Next, she presented an overview of the appointments for the 2nd quarter, highlighting the fact that a majority of members prefer in-person appointments, but some prefer Microsoft Teams or phone. She reported that DERP staff presented 7 RetireStrong seminars with a total attendance of 475, the majority attended the virtual seminars with 420 attendees versus 55 for in-person seminars.

   Ms. Kirchhevel informed the retirement board that annual member statements have been made available to active and inactive vested members. She noted that active members received an email on 7/10/2023 telling them their statement is available through their MyDERP.org account. Messaging was also included on DERP.org, the DEB, DenverHub, and digital signage. She noted that inactive vested member statements will be mailed the week of 7/24/2023 and are also available in members' MyDERP.org accounts. She mentioned that this yearly communication is a way to keep track of members, so they keep their account updated with the latest contact information. She summarized the retirement application process and stated that DERP staff is working on making the retirement application process through MyDERP.org smoother, so more retirees will elect this option.

   Ms. Kirchhevel commented on the contribution refunds process for nonvested employees who have chosen to leave city employment, noting that a YTD comparison yields the same percentage of lump sum refunds at about 68%, with rollover requests at about 32%. She reported that most retirees opt for Medicare only or no insurance instead of enrolling in DERP-sponsored medical plans due to the high costs, but members are taking advantage of DERP-sponsored dental and vision plans because they can use the insurance premium reduction dollars to cover the costs, and roughly $1 million dollars of the available $1.6 million dollars available for the insurance premium reduction are currently being used. She informed the retirement board that the membership services team will be hiring and training a new membership services

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representative, preparing for the annual retiree open enrollment in October, and holding a retiree health benefits fair on Wednesday October 4.

7. Jake Huolihan presented the Mid-year Expenditure and Demographic Review. He highlighted overall expenditures trending similarly to last year, with the exception of computer expenses. DERP's computer expenses are trending higher this year due to investment in securing the network for internal users and the member portal. He reported that, after 2022, retirements have settled down and returned to normal, tracking similarly to the prior year, with non-vested separation starting to trend down and retention rates returning to normal.

   He explained that the dollars in the DROP accounts have continued to decrease since the interest rate changed, with some of the higher dollar DROP accounts transitioning their funds to other accounts. He believes most of the remaining accounts are being used as a pension benefit as DROP was intended to be used. He reported that the number of MyDERP.org accounts continue to rise as new hires come to the city and the marketing and communications team continues to work with the city to coordinate with new hires to make sure MyDERP.org is the main source of communication.

8. Pamela Watson presented the Private Equity Review. She explained that DERP's private equity portfolio is composed of two fund-of-funds managers, Adams Street Partners and J.P. Morgan. She noted a target allocation of 9.0%, and that as of 03/31/23, the allocation had a market value of $291M or approximately 12.1% of the DERP portfolio. She also noted that Adams Street is 99% of this allocation.

   Ms. Watson described DERP's private equity portfolio as diversified by vintage year and strategy, and also diversified by subclass and geography. She explained that, while public and private markets are correlated, private valuations tend to adjust more slowly and more modestly, due to private markets' focus on investments that typically involve longer duration. She described the valuation policies of private equity firms, typically involving a combination of methods including public comps, private comp transactions, and discounted cash flow models to arrive at a fair market value, and discussed the private equity outlook, including a discussion of headwinds and tailwinds.

   She reported that DERP's private equity investments continue to significantly outperform public equities and DERP staff is pleased with the long-term performance of the private equity portfolio. She stated DERP staff continues to have a positive outlook for private equity despite a challenging current environment and a growing list of externalities that could negatively impact underlying portfolio companies in the short-term. She also highlighted that, although the allocation is currently overweight, vintage year diversification considerations have and may continue to result in additional fund

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commitments. Ms. Watson opened the floor for questions. John Dominguez asked questions about annual vintages, which Ms. Watson revisited.

9. Lisa Ramirez opened the floor for advisory committee member comments. No comments were received.

10. Lisa Ramirez opened the floor for public comment. No comments were received.

11. The next regularly scheduled DERP Retirement Board meeting is Friday, August 18, 2023 at 9:00 a.m.

12. The meeting was adjourned at 11:01 a.m.

Lisa Zuniga Ramirez
DERP Retirement Board Chair

Heather K. Darlington
DERP Executive Director

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