

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF A REGULAR MEETING  
OF THE BOARD OF TRUSTEES

April 19, 2016

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, April 19, 2016, at 10:00 a.m. in the System's Springfield Office located at 2101 South Veterans Parkway with a videoconference location at the Bilandic Building, Room N-703, 160 North LaSalle Street, Chicago, IL.

The following trustees were in attendance:

Leslie Geissler Munger, Chairperson  
David Morris, Vice Chairperson  
Shirley Byrd, Retired Trustee  
Robert Fanti, Active Trustee  
Thomas Allison, Appointed Trustee  
Renee Friedman, Appointed Trustee  
Yasmin Bates-Brown, Appointed Trustee  
Danny Silverthorn, Appointed Trustee  
Carl Jenkins, Appointed Trustee

Absent:

Alan Latoza, Retired Trustee

Others in attendance were:

Timothy Blair, Executive Secretary  
Jeff Houch, Assistant to Executive Secretary  
Steve Bochenek, System Attorney  
William Atwood, Director, Illinois State Board of Investment  
Johara Farhadieh, Deputy Director, Illinois State Board of Investment  
Ryan Gunderson, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Alex Rivera, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Alan Fowler, Manager, Accounting Division  
Gerry Mitchell, Chief Information System Officer  
Kevin Rademacher, IT Division Manager  
Casey Evans, Chief Internal Auditor  
Loren Iglarsh, Executive Committee Chairman  
Josh Potts, Comptroller's Office (by phone)  
Lynn Stoudamire, Central Management Services  
Barbara Baird, Manager, SERS Chicago Office  
Jennifer Staley, Recording Secretary  
Jeremy Hawk, SERS Trustee-elect

Chairperson Munger presided and called the meeting to order at 10:00 a.m. with a quorum present.

PUBLIC COMMENTS

Chairperson Munger asked if there were any members of the public in either the Springfield or Chicago location who wished to address the Board. There were none.

## CONSIDERATION OF ACTIVE TRUSTEE APPOINTMENTS – JEREMY HAWK AND STEPHEN MITTONS

Trustee Patricia Ousley, elected active Trustee, retired January 1, 2016, and therefore became ineligible to serve as an active member trustee. In addition, Trustee Robert Fierstein resigned from the SERS Board in July 2015. Both terms expire July 14, 2019. Only two active eligible members of SERS, Jeremy Hawk and Stephen Mittons, completed the required documents to run in the May Trustee election to complete the terms of Trustees Ousley and Fierstein. Secretary Blair pointed out no election was needed to fill the vacant positions, but rather Mr. Hawk and Mr. Mittons would become active member trustees on July 14, 2016.

Secretary Blair suggested that Mr. Hawk and Mr. Mittons be appointed by the Board to fill the vacancies immediately rather than leaving the positions vacant until July. He noted Mr. Mittons was unable to attend due to a prior work commitment but that Mr. Hawk was in attendance. Secretary Blair asked Mr. Hawk if he wished to introduce himself to the Board. Mr. Hawk noted for the Board that he worked for the Lottery at the Fairview Heights Office and that he was originally from the Jacksonville area. Chairperson Munger asked if anyone wished to make the nomination. Trustee Fanti nominated Jeremy Hawk and Stephen Mittons to the Board in the active member terms ending July 14, 2019. Trustee Silverthorn seconded the motion and it passed unanimously.

## REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT (ISBI)

William Atwood, ISBI Director, distributed copies of the Quarterly Review dated December 31, 2015, and introduced to the Board Johara Farhadieh, recently promoted to the position of Deputy Executive Director at ISBI.

Director Atwood began his review by noting that all returns provided in the report were net of fees and that the entire portfolio returned 0.8% during calendar year 2015, the same return provided by the benchmark. During the first six months of FY 2016, he pointed out the portfolio lost 3.2%, compared to a benchmark return of -2.0%. The total portfolio's three and five year returns as of December 31, 2015, were 8.3% and 7.6%, beating the benchmark returns of 7.6% and 6.8%.

Director Atwood continued by pointing out the Fixed Income Portfolio lost 2.2% during calendar year 2015, while the benchmark returned 0.4%. He attributed the underperformance of the portfolio to the effect of the strong dollar on non-U.S. fixed income instruments. Director Atwood continued his review of asset classes by advising the U.S. Equity portfolio lost 2.3% during the year, compared to the benchmark return of 0.5%, while the Hedge Fund of Funds portfolio lost 0.5%, compared to a benchmark loss of 0.3%. Deputy Director Farhadieh concluded the review by briefly noting the outperformance of the alternative asset classes.

Director Atwood informed the Board of the January 29, 2016 adoption of a revised asset allocation model by ISBI. The Hedge Fund allocation was reduced from 10% to 3%, while the Private Equity allocation was increased from 5% to 10%. In addition, within the Domestic Equity portfolio, the Board opted to change the allocation to more accurately reflect the market as a whole in regard to cap size and growth/value stocks. Along with the change to domestic equity market allocations, the Board opted to shift assets from active to passive management. The Board also voted to eliminate the allocation to non-U.S. investment grade bonds and increase the allocation to emerging market bonds.

Director Atwood noted these changes are being implemented by ISBI staff and the general consultant, Meketa Investment Group, with the main goal being the reduction of portfolio volatility while maintaining return and reducing fees. Chairperson Munger asked if there were any questions. Trustee Bates-Brown asked for additional details regarding the use of emerging investment managers. Ms. Farhadieh provided an explanation of the definition of emerging and minority managers and offered to forward additional information to the SERS trustees following the adoption of the latest report at the upcoming ISBI meeting.

Chairperson Munger asked if there were any additional questions for ISBI. There were none. Trustee Friedman moved to adopt the ISBI report. Trustee Bates-Brown seconded the motion and it passed unanimously. A copy of the ISBI Quarterly Report through December 31, 2015, is maintained in the ISBI office and made a part of these minutes as Exhibit A.

### REPORT OF CONSULTING ACTUARIES – EXPERIENCE REVIEW

Alex Rivera and Ryan Gunderson of Gabriel, Roeder, Smith & Company (GRS), Consulting Actuaries, distributed a report containing an experience review of the SERS actuarial assumptions. Mr. Rivera began the report by reminding the Board that the latest State Actuary's report recommended an annual review of the investment return assumption, and all economic assumptions prior to the commencement of the annual actuarial valuation work. In addition, Mr. Rivera noted the State Actuary recommended the adoption of a generational mortality table to better reflect an expected improvement in mortality rates, demographic assumptions specific to Tier 2 members, and an assumption regarding the amount of service credit established by SERS members at retirement for unused, accumulated benefit time.

Mr. Rivera reviewed an Executive Summary of the results, noting first the recommendation to reduce the investment return assumption from 7.25% annually to 7.0% annually. Based on the asset allocation of the ISBI investment portfolio and the expectations of 8 investment firms, as well as Meketa, he noted the fund had a 44% chance to earn 7% annually over a 20 year period. Trustee Friedman asked what the return assumption would have to be to increase the probability to 51%. Mr. Rivera noted the return assumption would have to be 6.60% based on the GRS analysis.

Chairperson Munger pointed out the Meketa return expectations are more optimistic than many of the investment firms' expectations used by GRS in the analysis. Mr. Rivera concurred, noting that Meketa projects a 54% likelihood of earning 7.25% annually and a 58% chance of earning 7.0% annually. Chairperson Munger continued the discussion by noting all of the changes recently made in the ISBI portfolio are expected to reduce fees and increase returns.

Based on further comment by Chairperson Munger, Mr. Rivera offered to provide more information to the SERS Board, but noted some of the more specific information is considered proprietary by the investment firms. Secretary Blair asked if the capital market assumptions used in the review could be provided to the Board without identifying the individual consultants. Mr. Rivera responded that he would check with his Chief Actuary and see if that option is available.

Secretary Blair offered to invite Meketa Investment Group to the July Board meeting to discuss the ISBI portfolio and Meketa's various return expectations, as the consideration of

the recommended assumptions could be deferred until the July meeting, as the actuarial valuation work would not begin until late July at the earliest. The Board agreed to defer consideration of all recommended assumptions and directed Secretary Blair to invite Meketa to the July Board meeting.

Following review of the other recommended assumptions, Mr. Rivera noted the adoption of all recommended assumptions would increase the unfunded liabilities of SERS by almost \$3.7 billion, with the generational mortality table (\$2.1 billion) having a larger impact than the lower investment return assumption (\$1.45 billion). Mr. Rivera concluded his report by noting the increase in the annual contribution due to the recommended assumptions of almost \$305 million. The generational mortality table increases the State contribution by an estimated \$175 million in the first year after the change, while the reduction in the investment return assumption to 7.0% results in an estimated annual State contribution increase of \$71 million in the first year after the change.

### REVIEW OF FIDUCIARY DUTY OF TRUSTEES

Steve Bochenek, SERS attorney, referred the Board to a memo regarding the fiduciary duties of the Board in relation to the State Actuary's opinion of the inadequacy of the statutory funding plan. He began by reminding the Board the memo was prepared at the request of Trustee Allison at the January Board meeting, when the recommendations of the State Actuary were presented and discussed. The memo concludes the statutory funding formula is outside the control of the Board and that the Board is required to comply with the Pension Code.

Secretary Blair reminded the trustees of the Board's recent adoption of a funding policy that recommends funding the System based on an annual State contribution equal to the annual normal cost of benefits earned plus an amount to amortize the unfunded liabilities over 25 years. Trustee Allison then asked Secretary Blair and Mr. Rivera about the four examples of action described at the end of Mr. Bochenek's memo. Mr. Rivera responded his firm will provide timely stress testing, and that he will correspond with the State Actuary about the scope of testing.

Secretary Blair continued that a full scope actuarial audit will be performed and that he will meet with COGFA, in addition to sending the usual letter to COGFA. Finally, Secretary Blair confirmed that the Fund regularly requests a change in the statutory funding method in the certification letters to the Governor and legislature. The memo is made a part of these minutes as Exhibit B.

### MINUTES OF THE JANUARY 12, 2016 BOARD MEETING

The minutes of the Board meeting held January 12, 2016 were presented to the members by Chairperson Munger. Copies of these minutes were previously provided to each trustee for preliminary review. Vice Chairperson Morris moved to approve the minutes as submitted. Trustee Fanti seconded the motion and all were in favor.

### REPORT OF CHAIRPERSON MUNGER

Chairperson Munger began her report by reminding the rest of the Board that the November State contribution to SERS and the other State-funded retirement systems have not yet been made due to ongoing cashflow problems. After a review of the amount of past, cur-

rent and projected unpaid State bills, Chairperson Munger informed the Board that her Office would be able to provide the missed November payment by the end of April. She concluded her report by noting that without a budget to provide the authority to pay bills and increased efficiency in governmental operations, the backlog of unpaid bills is expected to grow to \$11 or \$12 billion by the end of FY 2016. Even so, her office expects to make the May and June State contributions to SERS and the other State-funded retirement systems in full and on time.

#### REPORT OF ANY TRUSTEE

Chairperson Munger asked if any other trustees would like to offer a report. No other trustee offered a report.

#### REPORT OF AUDIT & COMPLIANCE COMMITTEE

Vice-Chairperson Morris, Chairman of the Audit and Compliance Committee reported that the committee had met prior to the Board meeting and introduced Chief Internal Auditor Casey Evans to provide the detailed report. CIA Evans noted the FY 2015 Compliance Audit had been completed and released by the Auditor General's Office, and contained three findings, with none considered material. He briefly reviewed the three audit findings and noted steps had been taken to avoid repeat findings in FY 2016.

He then provided updates on ongoing internal audit activity and asked the Board if there are any current or perceived risks that any Trustee would like to offer or discuss. There were none. Vice-Chairperson Morris added the Committee is recommending the addition of an internal auditor to provide additional support to CIA Evans and the Board.

#### REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Ethics. Gerry Mitchell, CISO and Ethics Officer, reminded the Board the annual Statements of Economic Interest are due to the Secretary of State's Office by May 1, 2015 and noted the annual ethics training is approaching. In addition, the Supplemental Statements of Economic Interest are due May 1<sup>st</sup>. He offered to provide SERS email addresses to all trustees to allow for Board-related activities to be done without the use of personal email and provide Board access to SERS members.

Systems Modernization. Mr. Mitchell informed the Board that progress continues on the re-engineering of the benefit setup system. In addition, he noted the submission of a 78 page application to the Social Security Administration (SSA) to allow SERS to access SSA systems and data. Mr. Mitchell also informed the Board of a meeting with the vendor of CMS' new health benefits administration system, noting the change will require several changes to the internal IT and workflow systems of SERS.

Computer Security. Mr. Mitchell noted the system had recently halted and recovered from a Ransomware attack.

Physical Security. Mr. Mitchell informed the Board panic buttons had been installed throughout the building and a review of secure areas had been completed. In addition, he noted staff was developing an emergency action plan and drills based on a State Police Threat Preparedness and Reference Guide.

#### REPORT OF THE EXECUTIVE SECRETARY

Preliminary Review of FY 2017 Budget Request. Secretary Blair presented the preliminary FY 17 budget for review. He noted the FY 17 preliminary budget request represents an increase of \$805,784, or 4.42%, from the FY 16 budget. This requested budget allows for the establishment of a call center in January 2017, with 4 call center representatives and a supervisor. In addition, the request includes \$60,000 for a full scope actuarial audit as recommended by the State Actuary in December 2015. These requested additions to the budget are partially offset by the elimination of one funded headcount in the Administrative Service Division and one funded headcount in the Service and Refunds Division.

Secretary Blair continued by noting the major impact included in the FY 2017 budget request is for the update and replacement of all obsolete infrastructure components, as well as PCs, monitors and network equipment. He referred the Board to the project charter for the SRS Hyper-Converged Infrastructure Project dated April 1, 2016, to provide an explanation of the infrastructure components request.

Chairperson Munger asked Secretary Blair to reduce the total request to as close to flat as possible from FY 2016. After discussion the operations budgeting process and the option of reducing the FY 2017 budget at the July meeting, Vice-Chairperson Morris moved to approve the budget as presented and Trustee Hawk seconded the motion. Trustee Allison asked if the budget request would be considered the actual budget or a preliminary budget. Secretary Blair answered the preliminary budget would be considered the budget until the Board considered the final request in July.

Chairperson Munger reiterated her wish to hold the budget at the FY 2016 level. Secretary Blair offered to make the changes required to do so but noted there was a motion on the floor to approve the budget as presented. Mr. Bochenek noted the previous motion could be defeated, and it was unanimously. Trustee Allison moved to approve a preliminary budget at the FY 2016 level. Trustee Friedman seconded the motion and all voted in the affirmative.

Legislative Update and Consideration. Secretary Blair directed the Board's attention to the legislative report, which provides information on legislation affecting SERS. He noted the System doesn't take positions on legislation that changes SERS benefits, but the Board may want to consider opposing any legislation that delays or reduces State funding to SERS, including the suspension of the continuing appropriation. Trustee Fanti motioned to oppose any legislation that would reduce or delay State funding, and Vice-Chairperson Morris seconded the motion.

Trustee Friedman asked for notification when there is opposition to any legislation and Secretary Blair agreed to do so for all Trustees. All trustees except Chairperson Munger voted in the affirmative and the motion passed.

FY 2016 Funding Update. Secretary Blair noted the report of Chairperson Munger and had nothing to add.

Accumulated Holiday Payout Bulletin – Joseph Conrad Letter. Secretary Blair informed the Board of a bulletin sent to all agencies in January 2016 directing payroll processors to stop taking employee contributions from lump sum payments made for accumulated holiday time, as statute expressly prohibits accumulated holiday time from the definition of pensionable "wages." SERS member Joseph Conrad asked his letter questioning the legality of the

bulletin, due to a contradictory administrative rule, be provided to the Board and the issue be put on the agenda for the April Board meeting.

Secretary Blair provided the Board with the relevant information, including a history of the law and the contradictory administrative rule. He noted that no Board action is necessary unless the Board wished to reverse or otherwise change the bulletin. After a brief discussion regarding accumulated holiday day pay and employee contributions already made by the affected member, no motion was offered to reverse or change the bulletin.

#### NEW BUSINESS

Chairperson Munger noted she had to leave the meeting due to a scheduling conflict and requested to move to new business on the agenda. Secretary Blair presented to the Board a resolution for Trustee Shirley Byrd, who was attending her last meeting as a Trustee. He thanked Trustee Byrd for her service to the Board and wished her continued happiness in her retirement. Trustee Fanti moved to adopt the resolution, Trustee Silverthorn seconded and all were in favor. A copy of the resolution is made a part of these minutes as Exhibit C.

Chairperson Munger turned the meeting over to Vice-Chairperson Morris and asked Secretary Blair to coordinate moving the July Board meeting to earlier in the month due to a scheduling conflict.

#### SECOND QUARTER FINANCIAL STATEMENTS

Alan Fowler, Accounting Division Manager, presented the financial statements for the second quarter of FY 16. He began by reminding the Board of the absence of the November State contribution, which required SERS to withdraw \$100 million from ISBI to pay November benefits. Mr. Fowler reported no other significant events affecting the second quarter financial statements and offered to answer any questions from the Board. Hearing none, Trustee Fanti moved to approve the financial statements as presented. Trustee Silverthorn seconded the motion and all trustees voted in the affirmative. Copies of these financial statements are attached to these minutes as Exhibit D.

#### APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the December 2015 and January, February and March 2016 Executive Committee minutes for review. There being no changes to these minutes, Trustee Fanti moved to approve as submitted. Trustee Hawk seconded the motion, which prevailed by the affirmative vote of all trustees.

#### OLD BUSINESS

Vice-Chairperson Morris asked if there was old business to discuss. There was none.

#### ADJOURNMENT

There being no further business to be brought before the Board, Vice-Chairman Morris adjourned the meeting at 12:20 p.m.

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Leslie Geissler Munger, Chairperson

Date: \_\_\_\_\_

ATTEST:

\_\_\_\_\_  
Timothy Blair, Executive Secretary

Date: \_\_\_\_\_