

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF TRUSTEES

April 25, 2017

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, April 25, 2017, 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:

Susana Mendoza, Chairperson
David Morris, Vice-Chairperson
Thomas Allison, Appointed Trustee
Yasmin Bates-Brown, Appointed Trustee
Renee Friedman, Appointed Trustee
Tad Hawk, Elected Active Trustee
Carl Jenkins, Appointed Trustee
Alan Latoza, Elected Retired Trustee
Stephen Mittons, Elected Active Trustee
Danny Silverthorn, Appointed Trustee
John Tilden, Elected Retired Trustee

Absent:

None

Others in attendance were:

Timothy Blair, Executive Secretary
Jeff Houch, Assistant to Executive Secretary
Steve Bochenek, System Attorney
Chris Maley, Illinois Office of the Comptroller
Chasse Rehwinkel, Illinois Office of the Comptroller
William Atwood, Director, Illinois State Board of Investment
Gerry Mitchell, Chief Information System Officer
Alan Fowler, Manager, Accounting Division
Casey Evans, Chief Internal Auditor
Staceyann Cabey-Kaufmann, Internal Auditor
Barbara Baird, Manager, SERS Chicago Field Service Office
Jennifer Staley, SERS Retiree
Jessica Blood, Recording Secretary
Loren Iglarsh, SERS Executive Committee Chairman
Bruce Sartain, Elected Active Trustee Candidate

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

PUBLIC COMMENTS

Chairperson Mendoza asked if there were any members of the public who wished to address the Board. Bruce Sartain introduced himself as a candidate for the trustee position.

CONSIDERATION OF APPOINTMENT OF ACTIVE TRUSTEE

Trustee Robert Fanti, elected active trustee, retired on March 1, 2017 and therefore became ineligible to serve the remainder of his term, which expires July 14, 2021. Four active eligible members, Shaun Dawson, Erin Moore, Bruce Sartain and Daniel Williams, completed the requirements to be considered by the Board to fill the active member trustee vacancy. Secretary Blair noted that one member, Susan Pennell, did not have the required number of valid original signatures to be considered.

Chairperson Mendoza asked if anyone would like to make a nomination. Trustee Hawk moved to nominate Shaun Dawson to fill the active member term ending July 14, 2021 and Trustee Silverthorn seconded the motion. With no further nominations, all voted in favor and Shaun Dawson was appointed to fill the vacancy.

RULES AND PERSONNEL COMMITTEE VACANCY

The retirement of Trustee Fanti created a vacancy on the Rules and Personnel Committee. Secretary Blair informed the Board that Trustee Hawk was interested in the position. Trustee Hawk concurred and added that he had experience with policy development.

Chairperson Mendoza asked if anyone would like to make a nomination. Trustee Silverthorn moved to nominate Trustee Hawk for the Rules and Personnel Committee vacancy. Trustee Latoza seconded the motion and it passed unanimously.

REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT

William Atwood, Director of the Illinois State Board of Investment (ISBI), distributed copies of the Quarterly Review dated December 31, 2016.

Director Atwood reported on actual asset allocation and target policy allocation. He noted the Fixed Income Composite amounted to 28.1% of the portfolio while the policy allocation target is 30.0%. He added the U.S. Equity Composite equaled 29.6% of the portfolio, considerably higher than the policy target of 23.0% of the portfolio. Director Atwood noted the reason the domestic equity portfolio was over weighted when compared to the target was due primarily to the liquidation of hedge fund assets that were deposited into the domestic equity portfolio until deployment to the private equity portfolio.

Director Atwood then summarized the net performance of the portfolio and various assets classes for the period ended December 31, 2016. He pointed out that the total fund composite was ahead of its benchmark for calendar year 2016 with a return of 6.4% (benchmark return of 6.3%) and a fiscal year to date return of 4% (benchmark return of 3.9%). Director Atwood added the Fixed Income portfolio lost 1.9% for the six months ended December 31, 2016, slightly lagging the benchmark, which lost 1.7%. The Domestic Equity portfolio returned 9.3% during the same period, ahead of the benchmark return of 8.8%.

Director Atwood concluded his performance review by noting the Real Assets portfolio returned 1.7% for the six months ended December 31, 2016, compared to the benchmark return of -1.7%. During the same period, the Real Estate portfolio returned 2%. significantly lagging the benchmark return of 4%.

Director Atwood reminded the Board members of the changes that had recently been made to the portfolio. He stated that at the March meeting, ISBI selected Nomura as a high

yield fixed income manager and added they would be discussing several topics at their June meeting, including an allocation to international emerging markets, the hedge fund portfolio and the private income portfolio.

Chairperson Mendoza asked if there were any questions for Director Atwood. Trustee Friedman asked about the fees charged by Nomura as the new fixed income manager and Director Atwood promised to get that to her. Trustee Allison asked about the progress in removing hedge funds from the portfolio and Director Atwood noted it was going well but would take some time to complete. Trustee Allison then asked about the Extended Performance Overview slides. Director Atwood answered that it is the breakdown of the performance of the different fund managers, measured against their own peer groups for each time period.

Chairperson Mendoza asked if there were any additional questions. There being none, she asked for a motion to adopt the ISBI Quarterly Review as presented by Director Atwood. Trustee Hawk moved to adopt the Quarterly Review for the period ended December 31, 2016. Trustee Latoza seconded the motion and it passed unanimously. A copy of the report is maintained in the ISBI office and made a part of these minutes as *Exhibit A*.

MINUTES OF THE JANUARY 10, 2017 BOARD MEETING

The minutes of the Board meeting held on January 10, 2017, were presented to the members by Chairperson Mendoza. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Allison moved to approve the minutes as submitted. Trustee Mittons seconded the motion and all were in favor.

REPORT OF CHAIRPERSON MENDOZA

Chairperson Mendoza introduced herself to the members of the Board. She began by stating that she understood the importance of making regular State contributions to SERS and that regular communication with SERS staff would be a priority. She noted that since December, the Office of the Comptroller (IOC) had been prioritizing payments to human services providers due to the State's ongoing fiscal crisis. Chairperson Mendoza added the IOC works daily to manage and prioritize payments to vendors and providers during the crisis.

Chairperson Mendoza continued that she went before the House appropriations committee in March and presented the lowest IOC Appropriations request in twenty years, adding that she thought it was important to lead by example in making cuts. She stated that she reduced the request for general revenue funds for the IOC operations budget by nearly 10%.

Chairperson Mendoza then informed the members of the Board that after nearly two years with no budget, there was a backlog of almost \$13 billion in unpaid bills. She added that the current fiscal crisis puts a strain on every program and service provider in the State as well as the entire pension system. Chairperson Mendoza stated that during the last quarter, Fitch downgraded Illinois' GO bond ratings, the sixth downgrade from the three rating agencies in the last two years. In addition, Standard and Poor's and Moody's delivered warnings on likely future downgrades if the State enters a third year with no budget.

Chairperson Mendoza continued her report by noting the IOC supports SB 1652 and HB 3649, the Debt Transparency Act, which would increase transparency and accountability to the budget process and provide information regarding late payment interest penalties, which her office estimates at upwards of \$800 million. The legislation would require State agencies

to report their debt on a monthly basis rather than only once a year, resulting in the IOC having a better handle on the State's true debt and keeping taxpayers more informed.

Chairperson Mendoza concluded her report by saying that she was looking forward to open and honest communication with the Board and asked if there were any questions. Trustee Friedman asked about late payment interest penalties. Chairperson Mendoza answered that after 90 days of nonpayment, there is an interest charge of 1% per month. Trustee Friedman noted the State should borrow to pay late bills, as the borrowing cost would be lower. Chairperson Mendoza answered that she believed that was part of the Senate grand bargain. Trustee Allison asked if it was possible for the interest issue to be dealt with apart from the grand bargain. Chairperson Mendoza answered that it would have to be accomplished through legislative action with approval by the Governor, regardless of what form it took.

Vice-Chairperson Morris asked if SERS was in line to get regular payments every month. Chairperson Mendoza answered yes but that every day without a budget complicates the ability of the State to meet its obligations. Vice-Chairperson Morris clarified that, from the Board's perspective, knowing whether regular payments would be made is essential. Chairperson Mendoza answered that all agencies will be revisiting how they plan out their finances as long as the fiscal crisis continues, but that the IOC would continue to work closely with SERS staff regarding the timing of employer contributions. Trustee Latoza asked what priority the Office of the Comptroller placed on making payments to SERS and Chairperson Mendoza answered it continued to be a top priority.

REPORT OF ANY TRUSTEE

Chairperson Mendoza asked if any trustee would like to offer a report. No trustee offered a report.

REPORT OF AUDIT & COMPLIANCE COMMITTEE

Audit and Compliance Chairman Morris noted the committee had met at 9 a.m. and introduced Chief Internal Auditor Casey Evans to provide the detailed report. He began by reminding the Board members that it was time to file the annual statements of economic interest and that he would be available after the meeting if there were questions.

Mr. Evans reported the committee discussed an internal audit covering optional service purchases and member contribution refunds, and noted three findings. The first finding related to weaknesses in internal control with service purchase calculations and the lack of a secondary reviewer in some cases. The second finding related to business continuity concerns of the division, with the division's procedures and manuals requiring updating and that duties should be shared among staff members. The third finding related to increasing internal controls over contribution refunds regarding confirming the identity of members who request a refund. Mr. Evans stated that the internal audit's recommendations to the division had been well received and a plan was put into place to remedy the issues.

Mr. Evans noted a procurement and purchasing audit, which yielded no findings but had three recommendations related to the Personal Identity Protection Act, a review of the fiduciary liability insurance policy and a review of the System's inclusion policy to make sure that certain metrics are met and that the System is aspiring to work with minority, female and disabled-owned businesses.

Mr. Evans stated that he anticipated the compliance examination would be issued within a few weeks and noted that he is aware of three potential findings. The first finding is non-compliance with the Fiscal Control and Internal Auditing Act due to not completing all required audits within a two year period. He added that with the addition of auditor Staceyann Cabey-Kaufmann, all audits would be completed as required. The second finding related to a Board vacancy, noting a shortage of one appointed trustee. The final finding related to weaknesses in IT change management controls.

REPORT OF RULES AND PERSONNEL COMMITTEE

Trustee Latoza reported the Rules and Personnel Committee had met on Monday, April 24th, 2017, at 2 p.m. in the System's Springfield Office. He noted that present were Trustees Silverthorn and Latoza, with Trustee Hawk as an observer. Also present were Executive Secretary Tim Blair and Jeff Houch, Assistant to the Executive Secretary. He then turned the report over to Mr. Houch.

Mr. Houch reported that the committee had reviewed recent rules that had been approved by the Joint Committee on Administrative Rules (JCAR) that took effect March 22nd. He stated that much of the rules dealt with modernizing disability rules, adding there was also a provision that strengthened compliance with the IRS the mandatory distribution requirement for inactive members over age 70 ½. In addition, Mr. Houch noted the creation of a rule at the request of CIA Evans allowing the suspension of future payments for any member holding four months' worth of checks until those checks are cashed. A condition of resuming payments would be enrollment in direct deposit.

Mr. Houch concluded his report by mentioning HB 2496, which deals with modernizing disability provisions, mainly by removing the application deadlines. Mr. Houch offered to answer questions and there were none.

REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Systems Modernization. Mr. Mitchell began his report by informing the Board of the continued testing of the benefit setup system, with plans to implement in the Judges and General Assembly Retirement Systems in May, in order to identify issues in the smaller systems before implementing in SERS. Mr. Mitchell noted IT is working on development in the Service and Refunds division for service purchases and added this work will assist with most of the audit issues identified in the division.

Mr. Mitchell continued that Retiree/Survivor Member statements were published on the Member Services website. Vice-Chairperson Morris asked how many members had registered for the Member Services website. Mr. Mitchell replied that 47,200 members had registered, accounting for about 39% of total SERS membership. Chairperson Mendoza asked if members had an option to choose online statements rather than printed statements. Mr. Mitchell stated this is not an option yet but is a goal. Chairperson Mendoza suggested an approach of encouraging members to choose emailed statements, but building into the system a trigger of mailing the statements in the event that the emailed version doesn't work.

Mr. Mitchell mentioned the IT division is implementing Office 365 as a pilot in the IT division in order to work out any issues. He added that after implementation, the Board members would be able to come to the website for meeting materials and get email alerts when new materials are added, providing a more secure way to communicate with SERS staff.

MyBenefits System Issues. Mr. Mitchell reminded the Board of the recent implementation of the MyBenefits insurance system by CMS. He noted that many problems continue and there seems to be a lack of progress and poor communication from CMS and the vendor, and the SERS IT Division continues to make system modifications due to these problems. Mr. Mitchell added that the new single sign on feature had been implemented, allowing members to reach the MyBenefits System through the SERS member services website. He stated that he had received information about how disaster recovery of the MyBenefits system will be handled, so the SERS Business Continuity Plan (BCP) can be updated. However, Mr. Mitchell stated that he was waiting on the State CIO to complete the security review of the system.

Trustee Allison inquired about the risk of hacking. Mr. Mitchell stated that SERS has the latest technology to protect against cyber-security breaches, that they upgrade their security patches directly upon notification from the company and annually have an outside entity perform a security assessment. Chairperson Mendoza asked about the nature of the recent security issue and why the vendor shut down over a weekend and how quickly the company responded. Mr. Mitchell responded that his staff found that member Social Security numbers could be comprised if a member used a public computer. CMS was contacted immediately and they contacted the vendor to shut down the site until the security issue was fixed.

Chairperson Mendoza asked if there were any further questions regarding the CISO's report. No further questions were offered.

REPORT OF THE EXECUTIVE SECRETARY

Review of Preliminary FY 2018 Operations Budget Request. Secretary Blair presented the preliminary FY 18 budget for review. He noted the FY 18 preliminary budget request represents an increase of \$69,325 or 0.38% from the FY 17 budget. The primary reason for the increase is from the increase in the retirement contribution rate. Such increase is the result of the recent change to a more conservative investment return assumption and the adoption of a generational mortality table, as the required contribution rate increased from approximately 44% in FY 2017 to more than 54% in FY 2018.

Secretary Blair continued by noting that the budget request included the call center being staffed for the entire year with a supervisor and four representatives and an additional representative for six months. The Group Insurance line was increased by \$50,000 due to the addition of call center staff.

Secretary Blair stated that the budget included a decrease in the Contractual line due to the removal of the actuarial audit, a projected decrease in the fiduciary insurance premium and a reduction in utilities costs. He added that there had been fairly major decreases in all lines except the Retirement line, which is up slightly over 20%.

Secretary Blair offered to answer any questions regarding the FY 2018 preliminary budget request. Trustee Allison asked if there was anything else included in the Retirement line increase besides the change in the interest assumption and the actuarial adjustments. Secretary Blair stated that the main cost driver was building in the longevity increases on the generational mortality table.

Chairperson Mendoza asked if there were any further questions regarding the preliminary FY 2018 budget. There being none, she asked if there was a motion to adopt the proposed budget. Trustee Silverthorn made a motion to adopt the preliminary FY 2018 budget request. Trustee Jenkins seconded the motion and it passed unanimously.

Legislative Update. Secretary Blair noted that Jeff Houch had provided a good legislative update, but would be happy to answer any further questions. None were offered.

FY 2017 Funding Update. Secretary Blair stated that the System was “caught up” and the IOC was doing a great job of keeping staff informed and making timely contributions.

Fiduciary Insurance Renewal. Secretary Blair introduced Mr. Timothy Bowen of Alliant Mesirow insurance services. Mr. Bowen began his presentation by comparing the recommended carrier, Ullico to the incumbent carrier, Euclid. He explained the highlights of the Ullico coverage, including Choice of Counsel the full limit of \$10 million in coverage for trustee expense and HIPAA violations. Mr. Bowen stated that there is not a Consent to Settle Clause with the Ullico coverage and added the Ullico policy contains a Cyber Liability provision of \$500,000 coverage, as well as Failure to Fund Coverage in the full limit of \$10 million.

Mr. Bowen then asked the Board if they had any questions regarding the policy provisions. Trustee Friedman asked if \$500,000 was all the Cyber Liability coverage that could be provided and Mr. Bowen stated that higher coverage could be purchased. Trustee Friedman stated that \$500,000 in coverage seemed negligible and then asked what the cost of the increasing the coverage would be. Mr. Bowen answered that comparable pension funds in the state buy stand-alone Cyber Liability coverage ranging from \$3-\$5 million and that this would be his recommendation. Trustee Allison asked if a stand-alone policy would include a fiduciary piece or if they should consider keeping the coverage under the fiduciary policy. Mr. Bowen replied that the Board would keep the Cyber Liability coverage under the fiduciary policy, but use the stand-alone policy for first party expenses. Trustee Tilden inquired what the cost of a stand-alone policy would be and Mr. Bowen answered that they can range between \$4,000 and \$5,000 on a per million dollar basis.

Trustee Allison then asked if the indemnification process would have to carry out before the Ullico coverage would start. Mr. Bowen stated that the Ullico coverage would start right away and act as a reimbursement mechanism to the indemnification process.

Chairperson Mendoza asked if there were any further questions for Mr. Bowen. Hearing none, Mr. Thomas Davis and Mr. Chris Pierce from Paradigm Insurance Group were brought in to present the recommended Euclid policy. Mr. Davis began the presentation by bringing the attention of the Board to the fact that the Euclid policy does not include restrictive Non-Indemnifiable Public Entity language. Trustee Allison stated that the Ullico proposal had stated the same information.

Mr. Pierce continued the presentation by stating that the Euclid policy included Choice of Counsel and added that there was no Hammer Clause included in the policy, allowing the insured to decide when to settle a case. Mr. Davis added that the coverage amounts for some provisions had been increased for better protection, such as the Voluntary Compliance Program Expenditures.

Trustee Allison stated that the previous presenters had recommended purchasing a stand-alone Cyber Liability policy. Mr. Davis agreed and replied that Lloyds was the market

for this type of policy designed for covering public funds and encouraged the Board to consider a more substantial Cyber Liability policy. Mr. Davis stated that their history as the fiduciary liability insurance provider to the Board showed that, though exposure had grown significantly higher, the policy's premiums had gotten considerably smaller.

Mr. Davis then directed the attention of the Board to the premium summary at the end of the presentation. Trustee Allison asked what the \$285,961 premium policy included that the \$255,878 premium policy did not. Mr. Davis stated that the difference occurred when, in the absence of indemnity, the deductible for the \$255,878 policy would go to zero.

Chairperson Mendoza asked if there were any other questions regarding the proposed policy. Hearing none, the members of the Board discussed the two options. Chairperson Mendoza then asked if there was a motion to accept either proposal. Attorney Bochenek brought the Board members' attention that the Ullico proposal did not include coverage for overpayment of benefits, while the Euclid proposal did. He added that this was an area where the System had problems in the past. Trustee Friedman moved to select the Ullico proposal on the condition that they provide coverage for overpayment of benefits with a limit of \$10 million for up to \$36,000; adding that if that was not possible, the Board select the Euclid policy with no deductible for \$285,961. Trustee Silverthorn seconded the motion. Attorney Bochenek amended that he would also recommend the Board request the indemnification language of the Ullico policy. All members voted in the affirmative and the motion carried.

Trustee Tilden made a motion that the Board request bids for a stand-alone Cyber Liability policy. Trustee Hawk seconded the motion. After some discussion with CIO Gerry Mitchell, all members voted aye and the motion carried.

REPORT OF ACCOUNTING DIVISION MANAGER

Chairperson Mendoza stated that she needed to turn the chair over to Vice-Chairperson Morris due to another commitment, but thanked the Board for their service and stated that she looked forward to working with them in the future.

Alan Fowler, Accounting Division Manager, presented the Cash Basis financial statements for the quarter ending December 31, 2016. He noted that the timing of the employer contribution was the cause for variances from previous quarterly reports. He reminded the Board of the sale of investments to cover November 2016 disbursements, which lead to an increase of \$60 million. Mr. Fowler stated that the other variance was due to processing the \$83.7 million repayment of the GRF employer contribution overpayment following the annual reconciliation with the Comptroller's Office.

Mr. Fowler then presented the FY 2016 Comprehensive Annual Financial Report to the Board. He noted that there were major formatting changes, including a full page presentation vs. a two column display done in the past as well as going from a multi-year to a single year presentation. He added that his staff had also done checks on fonts, tables and margins to make the presentation more clean and consistent. Mr. Fowler gave a brief overview of the various sections of the report and information they contained.

Mr. Fowler concluded his report by offering to answer questions. Hearing none, Trustee Latoza moved to approve the second quarter financial statements as presented. Trustee Silverthorn seconded the motion and it passed by unanimous vote. Copies of these financial statements are attached to these minutes as *Exhibit B*.

APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the December 2016, January, February and March 2017 Executive Committee minutes for review. There being no changes to the minutes, Trustee Latoza moved to approve. Trustee Hawk seconded the motion, which prevailed by the affirmative vote of all present.

OLD BUSINESS

Vice-Chairperson Morris asked if there was any old business to consider. There was no old business.

NEW BUSINESS

Vice-Chairperson Morris asked if there was any new business to be brought before the Board. Secretary Blair announced that Gerry Mitchell would be retiring effective June 30th. He stated that Mr. Mitchell had been instrumental in many of the System's advances, including the call center, the imaging system and the modernization of the IT division and thanked Mr. Mitchell for his service on behalf of the Board. Mr. Mitchell thanked the Board for all of their support over the years.

ADJOURNMENT

There being no further business to be brought before the Board, Vice-Chairperson Morris called for a motion to adjourn. Trustee Hawk made the motion to adjourn, seconded by Trustee Latoza. All members voted aye and the meeting adjourned at 12:26 p.m. Vice-Chairperson Morris thanked the Trustees and reminded them the next meeting is scheduled for July 25, 2017, at 10 a.m. in the Springfield Office with the videoconference location in the Bilandic Building.

Susana A. Mendoza, Chairperson

Date: _____

ATTEST:

Timothy Blair, Executive Secretary

Date: _____