

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS  
MINUTES OF THE REGULAR MEETING  
OF THE BOARD OF TRUSTEES

January 8, 2013

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, January 8, 2013, 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:

Judy Baar Topinka, Chairperson  
Thomas Allison, Trustee  
Michael Noser, Trustee  
Renee Friedman, Trustee  
David Morris, Trustee  
Patricia Ousley, Trustee  
Patricia Rensing, Trustee  
Danny Silverthorn, Trustee  
Virginia Yates, Trustee

Absent:

Lori Laidlaw, Vice Chairperson  
Shirley Byrd, Trustee  
Harold Sullivan, Trustee

Others in attendance were:

Timothy Blair, Executive Secretary  
Steve Bochenek, Attorney  
William Atwood, Director, Illinois State Board of Investment  
Nicholas Merrill, Manager, Accounting Division  
Staci Crane, Chief Internal Auditor  
Gerry Mitchell, Chief Information System Officer  
Denise Connelly, Manager, Human Resources Division  
Alex Rivera, Gabriel, Roeder, Smith & Company  
Paul Wood, Gabriel, Roeder, Smith & Company  
Joe Butcher, Auditor General's Office  
Ken Kent, Cheiron  
Mike Noble, Cheiron  
Loren Iglarsh, Office of the Comptroller  
Alexis Sturm, Office of the Comptroller  
Barbara Baird, SERS Chicago Office  
Dawn Blakeman, Recording Secretary

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

## PUBLIC COMMENTS

Chairperson Topinka asked if there were any members of the public in the Springfield or Chicago locations who wished to address the Board. There were no public comments.

## REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT

William Atwood, Director of the Illinois State Board of Investment (ISBI) distributed copies of the Executive Summary of the ISBI report for the period ended November 30, 2012, and addressed the Board. He first called attention to the portion of the report reflecting a 10.7% return, gross of fees, for the entire portfolio for calendar year 2012 through November 30. This return compares favorably to the total portfolio benchmark return of 10.5%. For the same time period, the Fixed Income portfolio returned 6.2%, while the benchmark returned 5.5%.

Director Atwood continued by noting the U.S. Equity portfolio, excluding the Hedge Fund of Funds allocation, returned 13.2% in calendar year 2012 through November 30, while the benchmark returned 15.0% over the same time period. He then directed the Board to the Hedge Fund of Funds asset class, which returned 6.9% in 2012 year to date, compared to the benchmark return of 4.4%. Over the same time period, the non-U.S. Equity portfolio performed very well, returning 16.7%, while the benchmark returned 13.5%.

Director Atwood then pointed out the Real Estate portfolio continues to struggle, returning 5.7% through November 30, while the benchmark returned 7.6%. He noted the Private Equity and Real Asset portfolios are doing fine, returning 13.0% and 6.9%, respectively, over the same time period.

Director Atwood noted that when the markets and economy are improving, the ISBI portfolio should improve. Conversely, when the markets decline, the ISBI portfolio will "lag" the markets. As a result, the portfolio through November 30 has performed nicely and as a whole the portfolio has continued to perform well through December and early January. He expects the total portfolio to outperform the benchmark for calendar year 2012.

Director Atwood pointed out the U.S. Equity Asset Class is lagging the benchmark, generally due to a performance lag of some of the small and mid-cap managers when compared to their respective benchmarks. The ISBI U.S. Equity portfolio is weighted towards small and mid-cap managers. He said the ISBI Board is not significantly troubled by this, as the Board has a very good relationship with many of these managers and over time they have done well for ISBI.

Director Atwood informed the Board that changes were made in the Real Estate Portfolio at the December ISBI Board meeting. The Board had been approached by CBRE, who currently manages approximately \$270 million, about moving some of those assets into a new Core Commingled Fund they are starting, in order to provide better diversification in the ISBI portfolio, provide better liquidity, and cut management fees in half. Similarly, another Real Estate manager, Clarion, has about \$90 million in ISBI assets that are not in-

vested. ISBI has decided to move these assets into a Core Commingled Fund, primarily to provide better diversification and “get the money to work.”

Director Atwood concluded by reiterating that returns continue to be affected by “macro” decisions made in Washington D.C. and throughout the world and offered to answer any questions the Board may have.

Trustee Friedman asked Director Atwood why liquidity is better as a result of the changes that he described regarding the Real Estate portfolio. He answered by explaining that the change allows the Board to have “ownership units” in a pool of assets, rather than actually owning real assets. These “ownership units” or shares can be liquidated more readily than hard assets, but they are harder to liquidate when the assets aren’t performing well.

Trustee Noser followed up by commenting that the investment return assumption was lowered by the Board to 7.75%, and that the current 10-year return provided by the ISBI portfolio was about 6.5% annually. He asked Director Atwood about the connection between the assumption and how assets are allocated within the portfolio.

Director Atwood responded that the actuarial assumption is predicated on an assumption about inflation and the expectation of real returns. Given an inflation assumption of 3.5%, the expectation of real annual returns of 400 basis points above inflation is not unreasonable. If inflation is 5% or 6% annually, as was the case in the 1980’s, achieving a 7.75% annual return should be much easier. Conversely, if the economy remains in a long period of historically low inflation or deflation, the 7.75% annual target will be more difficult to achieve.

Trustee Morris moved to accept the ISBI Report for the period ending November 30, 2012 and Trustee Rensing seconded the motion, which passed unanimously. A copy of the report is maintained in the ISBI office and made a part of these minutes as Exhibit A. Chairperson Topinka and the Trustees thanked Director Atwood for his informative report and excused him from the remainder of the meeting.

## STATE ACTUARY

Mike Noble and Ken Kent of Cheiron and Joe Butcher of the Auditor General’s Office appeared at the meeting at the request of the Board to answer questions. Executive Secretary Blair introduced everyone and informed Mr. Noble and Mr. Kent that the Board was interested in their opinions on the current investment return assumption and their experiences with other similar public plans. Chairperson Topinka followed up and noted that it appeared that there seemed to be a lot of findings in the State Actuary’s review of SERS’ actuarial assumptions and FY 12 valuation report. She then asked if it appeared that the Board is making progress.

Mr. Kent responded that with the recent reduction in the investment return assumption to 7.75% that he felt the Board is making progress. But, he cautioned that given the results of the analysis used in dropping the assumption to 7.75%, future investment returns may even be lower than the reduced assumption. Thus, Cheiron, as the statutory State Actuary, recommended the Board continue to monitor the assumption closely.

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Chairperson Topinka followed up by asking if Mr. Kent thinks our assumptions are realistic. He answered in the affirmative. Trustee Allison asked if that meant the investment rate assumption is consistent with the expectations of investment professionals and the capital markets. Mr. Kent responded that selecting an investment return assumption that is more conservative than the investment community helps provide conservatism in funding policy.

Trustee Allison then asked if the investment return assumption can be used to offset the backloading of the statutory funding plan. Mr. Kent offered that conservative assumptions may be used to compensate for the funding policy and improve the probability of achieving funding objectives. Trustee Allison asked about the recommended "asset corridor." Mr. Kent responded that the actuarial asset values and market values may get further apart over time. An "asset corridor" would prevent that divergence from happening. After further brief discussion on the asset corridor, Chairperson Topinka thanked the actuaries and Mr. Butcher for their time and excused them from the remainder of the meeting.

#### FINAL CERTIFICATION OF FY 2014 EMPLOYER CONTRIBUTION RATE

Chairperson Topinka called the Board's attention to the FY 14 actuarial certification of the required employer contribution. The final certification is unchanged from the preliminary certification approved at the October 30, 2012 Board meeting. Trustee Morris moved to certify the FY 14 employer contribution rate. Trustee Silverthorn seconded the motion and all were in favor. The FY 14 certified employer contribution is \$1,662,667,000, or 38.435% of payroll. In addition, debt service in the amount of \$81,198,000, or 1.877% of payroll, was certified for non-GRF payrolls.

#### MINUTES OF THE OCTOBER 30, 2012 BOARD MEETING

The minutes of the meeting of the Board of Trustees held October 30, 2012 were presented to the members by Chairperson Topinka for approval. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Yates moved to approve the minutes as submitted. Trustee Rensing seconded the motion and all were in favor.

#### REPORT OF CHAIRPERSON TOPINKA

Chairperson Topinka stated she had nothing to report but suggested the Board continue to follow the proceedings in General Assembly. She noted that as pension reform has continued to be discussed, Illinois has experienced several downgrades in the credit rating and that can probably be expected to continue.

#### REPORT OF CHIEF INTERNAL AUDITOR

Chairperson Topinka introduced Staci Crane. Trustee Rensing made a motion to go into Executive Session to discuss possible internal control weaknesses and the identification of potential fraud risk areas. Trustee Morris seconded the motion. A roll call vote was taken by Recording Secretary Blakeman with all trustees present voting in the affirmative.

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The Board returned to Open Session.

## REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Comprehensive Risk Assessment Status. Mr. Mitchell informed the Board he had been working on the Comprehensive Risk Assessment based on the discussion and concern expressed by the Board at the October meeting. He explained that a significant amount of risk assessment had been performed during the ongoing updating of the Business Continuity Plan (BCP) and briefly outlined the risks that have been identified in the BCP.

Mr. Mitchell then pointed out that a template has been created and provided to each Division Manager in order to identify non-IT and more general types of risks. Preliminarily, the top risk is potential internal and external fraud. He then pointed out that it won't take 2 years to complete the Risk Assessment as discussed at the October meeting, but probably closer to 6 months and then offered to answer any questions the Board may have. No questions were offered and Mr. Mitchell continued his report.

Systems Modernization. Mr. Mitchell informed the Board that a Projects Steering Committee (PSC) is being established to drive the modernization and provide all managers with an avenue for input in the modernization process. There are also enhancements to the Time and Attendance being developed as a result of the recent audit.

Mr. Mitchell further continued by telling the Board the Active Member Systems re-engineering (Phase II) continues and that the direction of the Website development will be determined by the PSC. He then mentioned he had reviewed features of other systems' websites for presentation to the PSC as work begins on prioritization of functionality and services to be offered. One of the first features being considered is a Web-based software package for the scheduling of workshops for members.

Chairperson Topinka stated she has some concerns as we develop the technology to provide more services electronically to SERS members and retirees. She explained that her main concern is the security of member information while another concern is members who may not have access to computers. Mr. Mitchell responded that we share the Chairperson's concerns about security and that we don't plan on relying entirely on technology to provide customer service, but rather as a customer service option for SERS members and retirees.

Imaging. Mr. Mitchell reported the imaging backfile conversion is nearing completion as all Lektrievers have been emptied and dismantled. He expects all microfiche to be imaged by the end of the month. Chairperson Topinka asked Mr. Mitchell if members seem to be pleased with the quicker service that results from the easier access to member data.

Trustee Rensing asked to be recognized to respond to the Chairperson's question. She explained that her father-in-law, who retired from SERS in 1976, recently passed away and she came to SERS to submit the required paperwork on behalf of her mother-in-law. She told the Board that staff had Mr. Rensing's entire file available with the push of a button and that she could have been in and out of the SERS office in 10 minutes. Trustee Rensing continued by saying she was very impressed and glad to be a part of the changes that are happening at SERS.

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Disaster Recovery. Mr. Mitchell reported that Business Continuity Planning (BCP) is ongoing and that as part of the process, systems had been tested at the new CMS Northern Data Center. He continued that all equipment and network upgrades have been ordered for the recovery of local systems and that all backup files are now being stored in St. Louis, rather than at the local PNC bank, which may be too close to the SERS offices to be effective in some disaster scenarios.

Trustee Morris mentioned he had reviewed the meeting material and asked if a generator was being considered during the BCP process. Mr. Mitchell then noted that during the BCP process, staff has been discussing the merits of installing a generator. Now that member files have been imaged, the loss of electricity in the building for an extended period is one of the biggest risks faced by SERS. A generator big enough to power the whole SERS building would alleviate this risk and allow staff to function during a power outage.

Following a brief discussion on the merits of a generator, Mr. Mitchell told the Board that an estimate on the cost of a generator, including required changes to the building and installation, would be at most \$250,000. Trustee Silverthorn mentioned that he is on the Peoria Civic Center Board and they had a similar Caterpillar generator installed for \$75,000, but that in this case \$150,000 may be a good estimate.

Trustee Morris added that the Department of Children and Family Services recently acquired a surplus generator from the military for use with the Child Abuse Hotline. Chairperson Topinka added the Comptroller's Office has received useful surplus property from the National Guard. Mr. Mitchell was charged with first looking into the ability to procure a surplus generator from the State or National Guard prior to attempting to purchase a generator. Trustee Noser then moved to have Mr. Mitchell present at the April Board meeting the cost of acquiring and installing a generator. Trustee Ousley seconded the motion and all were in favor.

Chairperson Topinka then asked Secretary Blair to look into window treatments that would reduce the cost of heating and cooling the SERS Springfield Office. Trustee Silverthorn moved to approve Mr. Mitchell's report and Trustee Ousley seconded the motion. All were in favor.

## REPORT OF THE EXECUTIVE SECRETARY

Updated Bylaws and Board of Trustees Manual. Secretary Blair drew the Boards' attention to a newly created Board Manual. He explained the current Bylaws have not been updated recently and there isn't a Board Manual that contains all the information the Trustees need. He provided a very brief overview of the proposed Board Manual, including the creation of an Audit and Compliance Committee and a Rules and Personnel Committee.

Trustee Morris asked if he had assigned an indemnification agreement as required by the current bylaws. Secretary Blair answered that all new Board members sign an indemnification agreement along with an Oath of Office. Trustee Morris then asked if Board members are required to attend 8 hours of training per year. Secretary Blair answered in the affirmative and told the Board he would provide more specifics on upcoming training opportunities.

Trustee Allison asked Secretary Blair to explain the proposed roll call vote requirement on any and all motions involving an expenditure of moneys or the creation of a liability to the System. Secretary Blair explained he thought that referred to the Budget approval process, but he would verify that and let the Board know. And he would expect that process to apply to any other proposed expenditure that is not included in the budget. Steve Bochenek, the system's attorney opined that the language as presented may require a roll call vote on everything brought before the Board.

Based on the discussion, Secretary Blair offered to have Mr. Bochenek review the proposed Board Manual and consider it at the next meeting. Trustee Morris then requested the Board be supplied with a redlined version of Board Manual so the proposed changes could be easily identified. Secretary Blair agreed to provide the redlined version to all Trustees.

Trustee Allison referred to the Public Comment portion of the proposed Board Manual and asked if that was part of current procedures. Executive Secretary Blair responded that a new law requires the Board to provide for allowing public comment. Chairperson Topinka then stated that she thought the issue needed to be further defined for the Board and all Trustees agreed. Trustee Allison then asked if the proposed Board Manual would allow Loren Iglarsh to remain on the Executive Committee as the designee of the Chairperson. Secretary Blair answered in the affirmative.

Trustee Training Opportunities. Secretary Blair told the Board he would forward some training opportunities to the Board prior to the next meeting. Alexis Sturm from the Comptroller's Office mentioned that the ISBI provides training to the ISBI Trustees and that perhaps they would include the SERS Board in that training. Secretary Blair agreed to check into the ISBI training opportunities and forward all information to the Board.

#### FIRST QUARTER FINANCIAL STATEMENTS

Nicholas Merrill, Accounting Division Manager, presented the financial statements for the first quarter of Fiscal Year 2013. Mr. Merrill briefly reviewed the financial statements and noted the main difference from recent years is the stable employer contribution. A \$142.0 million increase in the employer contribution in the 1<sup>st</sup> quarter, when compared to the same quarter last year, allowed SERS to decrease 1<sup>st</sup> quarter ISBI withdrawals by \$174.0 million.

On motion by Trustee Ousley, seconded by Trustee Rensing, and by unanimous vote, the Board approved the financial statements as presented. 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 October, November and December 2012, Executive Committee minutes for review. Trustee Morris asked about the write-off process mentioned in the Executive Committee Minutes. Mr. Merrill provided a brief overview of the history of the write-off process. Essentially, the historical concern was the possibility of fraud for inactive accounts. The write-off process was implemented to minimize this possibility.

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Chairperson Topinka asked about the application of the Unclaimed Property Act to inactive and unclaimed retirement accounts. Secretary Blair explained the retirement systems have not and are not subject to the Unclaimed Property Act.

There being no changes to these minutes, Trustee Sullivan moved for adoption. Trustee Morris seconded the motion, which prevailed by the affirmative vote of all trustees.

#### OLD BUSINESS

Trustee Allison requested a discussion of a memo prepared by Sorling regarding the application of the Administrative Procedures Act at the next meeting.

#### NEW BUSINESS

Trustee Friedman asked if the Board should prepare a statement for the legislature regarding the failure to address the underfunding of the retirement systems during the 97<sup>th</sup> General Assembly. Mr. Bochenek responded the Board, as fiduciaries, may want to wait to respond to eventual action or litigation that may be taken by the General Assembly. Chairperson Topinka agreed the prudent course of action may be to monitor legislative activity and ensuing litigation before deciding on the appropriate course of action. Based on this discussion, no action was taken.

#### ADJOURNMENT

There being no further business to be brought before the Board, Trustee Morris moved for adjournment at 12:05 P.M. The adjournment motion was seconded by Trustee Yates and all were in favor.

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Judy Baar Topinka, Chairperson

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

ATTEST:

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

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

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