

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF TRUSTEES

January 12, 2016

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, January 12, 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
Carl Jenkins, Trustee
Robert Fanti, Trustee
Thomas Allison, Trustee
Renee Friedman, Trustee (by phone)
Alan Latoza, Trustee
Yasmin Bates-Brown, Trustee

Absent:

Shirley Byrd, Trustee
Danny Silverthorn, Trustee

Others in attendance were:

Timothy Blair, Executive Secretary
Steve Bochenek, Attorney
William Atwood, Director, Illinois State Board of Investment
Alan Fowler, Manager, Accounting Division
Gerry Mitchell, Chief Information System Officer
Jeff Houch, Assistant to Executive Secretary
Casey Evans, Chief Internal Auditor
Loren Iglarsh, Executive Committee Chairman
Barbara Baird, Manager, SERS Chicago Office
Jennifer Staley, Recording Secretary
Lynn Stoudamire, Central Management Services

After some technical difficulties with the videoconference equipment, Chairperson Munger called the meeting to order at 10:20 a.m. with a quorum present. Trustee Friedman requested to participate by phone. Vice-Chairperson Morris moved to allow Trustee Friedman to participate by phone. Trustee Fanti seconded the motion and all trustees present voted in the affirmative.

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.

MINUTES OF THE OCTOBER 27, 2015 BOARD MEETING

The minutes of the Board meeting held on October 27, 2015, were presented to the members by Chairperson Munger. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Bates-Brown moved to approve the minutes as submitted. Trustee Latoza seconded the motion and all were in favor.

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 for the period ending September 30, 2015, and noted the report was prepared by the new general consultant, Meketa Group. He began by reviewing the returns of the various asset classes for the one year period ended September 30, 2015, noting the entire portfolio returned 0.6% (net of fees) over the period, while the benchmark lost 0.4%.

Director Atwood continued the review by noting that over the year ending September 30, 2015, the Fixed Income portfolio lost 1.9% and the U.S. Equity portfolio lost 0.9%. Both portfolios underperformed their benchmarks, which returned 2.3% and -0.5%, respectively. Mr. Atwood continued by briefly reviewing the returns of the other asset classes, noting that several asset classes, and the portfolio as a whole, had outperformed the respective benchmarks.

Director Atwood continued his presentation by informing the Board that the Meketa Group was in the process of preparing an asset allocation study for ISBI. There is a special Board meeting scheduled for January 29, 2016, so that Meketa can present the proposed asset allocation based on the study for ISBI consideration at the March 11, 2016, regular meeting. Director Atwood expects the Board to reduce the utilization of active managers and increase the utilization of passive managers in the equity portfolio. In addition, he expects the Board to consider reducing the allocation to the value and small cap equity portfolios to more reflect the global equity markets and reduce overall equity exposure.

Director Atwood continued that he expects the Board to consider at the March meeting the possibility of reducing hedge fund exposure from 10% to 5% or 6% or possibly to 0% and increasing private equity exposure from the current 5% allocation and also create some exposure to inflation-linked U.S. treasuries, in order to provide some protection against inflation. He continued that there may be a reduction in exposure to global bonds.

Director Atwood asked if there were any questions on the portfolio review or upcoming ISBI meetings. Trustee Allison asked about the universe rankings included in the new version of the ISBI report. Director Atwood agreed the report provided more detail than previous versions. Trustee Allison followed up by asking if anyone is on the ISBI watch list. Director Atwood responded that Segal Bryant & Hamill were put on the list for near- and mid-term underperformance.

Trustee Allison then noted that Herndon Capital Management had been a very low performer when compared to their peer group, as noted in Meketa Groups quarterly report. Director Atwood responded that Herndon Capital Management had been terminated at the September ISBI meeting, along with three other underperforming managers. Trustee Allison then asked if the new ISBI Board would scrutinize individual managers, as there still seemed to be some underperforming managers, and if the Board was cognizant of management fees.

Director Atwood answered in the affirmative and assured Trustee Allison that the new members of the Board were very engaged in Board business and very aware of the management fees paid by ISBI.

Director Atwood referred the Board to the ISBI annual report on minority utilization and offered to answer any questions from the Board. Trustee Bates-Brown asked if the report was new and Trustee Allison asked if ISBI had directed brokerage. Director Atwood responded the report is filed annually pursuant to statute and the ISBI does not have directed brokerage, but that they encourage managers to use emerging and minority brokerage firms. Trustee Bates-Brown then asked about providing additional breakdown into emerging or minority groups. Director Atwood noted that additional detail is reported to the ISBI quarterly and promised to provide the information to Trustee Bates-Brown.

Chairperson Munger asked if there were any additional questions. There being none, Trustee Allison moved to approve the ISBI Quarterly Review for the period ending September 30, 2015. Trustee Jenkins 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 Munger thanked Director Atwood for his report and excused him from the remainder of the meeting.

REPORT OF CONSULTING ACTUARIES

As the consulting actuaries were unable to attend, Secretary Blair reviewed the State Actuary's report, including the GRS/SERS response. He also presented the final version of the FY 2015 valuation report and the FY 2017 certified State contribution. He noted the review of the stress testing would be deferred until the April meeting.

State Actuary's Report. Secretary Blair noted the State Actuary's report concluded that the assumptions and methodology used for the FY 2015 valuation are reasonable and that the certified contributions were calculated in accordance with State law. The State Actuary recommended SERS complete a full replication actuarial audit. Secretary Blair noted his agreement with the recommendation and advised the Board that he was preparing a Request for Proposal (RFP) to find an actuarial firm to perform the audit, with the goal of having the audit completed prior to June 30, 2016.

Secretary Blair continued his review by pointing out the State Actuary suggested changing the statutory funding method in order to avoid continued systematic underfunding of the System, and that the System's consulting actuaries agree. Trustee Allison asked if the Board had any legal options to strengthen the funding plan. Chairperson Munger noted the legislature had not changed the funding plan, probably due to the inability of the State to afford additional employer contributions.

Trustee Allison added that he was concerned specifically with the fact that the State Actuary had recommended an actuarial funding method that is stronger than the statutory funding plan and questioned how the Board should formally and legally respond to this recommendation. Steve Bochenek, the System's attorney, said he would review the issue and report back to the Board at the April meeting. Trustee Allison then made the motion to have Mr. Bochenek review the issue and report his finding back to the Board. Trustee Friedman seconded the motion and all present voted in the affirmative.

Secretary Blair continued by briefly reviewing the remainder of the State Actuary's recommendations and noted all recommendations would be addressed prior to the June 30, 2016 actuarial valuation. Chairperson Munger noted the State Actuary is recommending a conservative approach to funding and she agrees with the approach given the financial markets and low funding level. A letter outlining all of State Actuary's recommendations and the GRS/SERS response to these recommendations is attached and made a part of these minutes as Exhibit B.

FY 2017 State Contribution Certification. Secretary Blair presented and reviewed the documents that will be used to certify the FY 2017 State contribution of \$2,097,430,000, or 44.568% of projected payroll, including \$82,969,000, or 1.763% of payroll, to pay the debt service on the pension obligation bonds issued in FY 2003. Chairperson Munger asked if there was a motion to approve the FY 2017 State contribution amount. Trustee Latoza moved to approve the FY 2015 actuarial valuation and the FY 2017 employer contribution as presented. Trustee Fanti seconded the motion and all Trustees voted in the affirmative.

REPORT OF CHAIRPERSON MUNGER

Chairperson Munger noted the continuing lack of a State budget and reported that her Office hoped to provide all required FY 2016 funding for SERS by the end of the fiscal year, with the plan being to make the missed November State payment in April. She then thanked the Board for their work over the last year and offered to answer any questions. There were none.

REPORT OF ANY TRUSTEE

Chairperson Munger asked if any other trustees would like to offer a report. There were none.

REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Systems Modernization and Computer Security. Gerry Mitchell, CISO, noted that quality assurance testing continues on the pension setup process that will automate many of the current manual processes. In addition, the development of the new disability system has moved from the collection of business requirements to the actual development of the system.

Mr. Mitchell reported on the completion of additional functionality on the employer website and that network monitoring systems have been installed to alert staff more quickly to any network problems.

Risk Assessment. Mr. Mitchell reported that activities related to the risk assessment are ongoing, including the completion of physical security training conducted by the Illinois State Police. He added that additional alarms would be installed so that all employees would be sufficiently notified of a problem. In addition, he noted the possibility of implementing active shooter drills for the agency.

Member Services Website. Mr. Mitchell noted that 33,250 members have registered with the website, which is 29.4% of active members and 12.6% of retirees. He noted that more than 9,000 members have accessed the system in the last 30 days.

IT Transformation. Mr. Mitchell reminded the Board of the recent initiative to consolidate all IT staff within the Department of Central Management Services (CMS) and his concerns over the effect the initiative would have on SERS. He informed the Board of a meeting between SERS management and the Statewide CIO, Hardik Bhatt, and the IT Transformation project manager. The stated goal of the IT Transformation project is to create efficiencies in common business areas. Mr. Mitchell noted that SERS management is concerned that SERS, as a retirement system, shares few common business areas with other agencies, and that there would be little benefit to SERS or CMS if SERS IT staff became employees of CMS.

Mr. Mitchell told the Board that SERS and the Illinois Department of Transportation (IDOT) are far ahead of the other agencies in the area of technology and IT modernization, including system development methodology, and the rest of the State may benefit from leveraging SERS expertise. At the recent meeting, SERS management expressed the willingness to share experience and expertise with the Transformation team but didn't see the need to have SERS IT employees become CMS employees.

Mr. Mitchell noted for the Board that Secretary Blair explained to the IT transformation team that system management reported to the Board of Trustees and SERS is not a typical agency. SERS is non-appropriated and not subject to the Procurement Code, among other significant differences. In response, the State CIO offered to provide information to be presented to the Board regarding the Transformation project. Secretary Blair noted that the information had not yet been provided but promised to inform the Board when this information is made available.

Trustee Friedman commented that she didn't understand how SERS employees can become CMS employees and still be responsible to the Board. Secretary Blair noted his agreement but that SERS management is willing to help make the IT transformation project successful if it also makes sense for SERS. Chairperson Munger offered to talk to State CIO Bhatt and noted the Comptroller's involvement in the ERP project. Mr. Mitchell ended his presentation by thanking the Board for their ongoing support of the modernization efforts.

REPORT OF AUDIT & COMPLIANCE COMMITTEE AND CHIEF INTERNAL AUDITOR

Vice-Chairman Morris reported the Audit and Compliance Committee had met prior to the Board meeting as scheduled at 9 a.m. He then referred the Board to Chief Internal Auditor Casey Evans to provide a brief report to the Board.

Mr. Evans began by noting the Financial Audit had been released by the Auditor General and that it contained two material findings. The first finding noted inadequate controls over census data as reported by the various agencies. Mr. Evans noted that there was a plan in place to audit data as reported by the agencies in order to prevent the finding from being repeated. He continued the second finding related to the vacancy in the Chief Internal Audit position for a portion of FY 2015. Due to the vacancy, not all required audits had been completed, resulting in the finding.

Mr. Evans continued his report by briefly reviewing ongoing internal audits and disability investigations, including the case of a disability recipient working as a counselor in her own business. He then noted the implementation of a new fraud hotline, and concluded his report by offering to answer questions from the Board. In response to an overpayment ques-

tion by Trustee Allison, Secretary Blair explained the options available to recoup overpayments, including the ability to intercept refunds and future benefit payments, and involuntary withholding of other State payments through the Attorney General's Office and Comptroller's Office.

REPORT OF THE EXECUTIVE SECRETARY

Accounting Cost Allocation Methodology. Secretary Blair introduced Alan Fowler, Accounting Division Manager, to explain the proposed Accounting Cost Allocation Methodology. Mr. Fowler explained the purpose of the policy is the fair and adequate allocation of the personnel costs associated with the SRS Accounting Division between the Judges' Retirement System (JRS), General Assembly Retirement System (GARS) and SERS.

Mr. Fowler explained that for all three systems, the Accounting Division produces financial statements and reports, processes cash deposits, and reviews and maintains active member accounts. Previously, JRS and GARS had fully funded an Accounting Division position that worked on SERS related issues to a large extent. This new cost allocation methodology provides a more reasonable and documentable way to allocate Accounting costs among the systems and parallels the cost allocation methodology put into place during FY 2015 for the IT modernization costs. Effectively, the methodology allocates costs based on a five year rolling average of total membership served.

Trustee Latoza moved to approve the policy and Trustee Bates-Brown seconded the motion. All trustees voted in favor of adopting this Accounting Division cost allocation methodology.

FY 16 Funding Update. Executive Secretary Blair noted that Chairperson Munger had provided a good update on FY 2016 funding and that he had nothing to add.

FIRST QUARTER FINANCIAL STATEMENTS

Alan Fowler, Accounting Division Manager, presented the financial statements for the first quarter of FY 2016. Mr. Fowler noted that in comparison to the prior quarter and the corresponding quarter from the prior year, there was nothing significant to report. He continued by referring the Board to the recently completed FY 2015 Comprehensive Annual Financial Report (CAFR), noting the document provides basic financial statements for SERS and is reviewed and audited by the Auditor General.

Mr. Fowler than briefly outlined each of the Sections of the CAFR and explained the significant compilation of information for the CAFR. He noted the timing and extent of the work involved in completing the CAFR by December of each year and the process of working with the Auditor General during the audit process. Mr. Fowler concluded his review by pointing out that every transaction at SERS ends up on the financial statements and is therefore reflected in the CAFR. Trustee Allison complimented Mr. Fowler on the design of the report and thanked him for his continued efforts on behalf of the System.

Following the review of the CAFR, Chairperson Munger asked if there were any questions on the CAFR or the first quarter FY 2016 financial statements. There being none, Trustee Allison moved to accept the statements. Trustee Bates-Brown seconded the motion, which passed unanimously. Copies of the financial statements are attached to these minutes as Exhibit C.

APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the October and November 2015 Executive Committee minutes for review. There being no changes to the minutes, Trustee Fanti moved to approve. Trustee Jenkins seconded the motion, which prevailed by the affirmative vote of all present.

OLD BUSINESS

Chairperson Munger asked if there was any old business to consider. There was no old business.

NEW BUSINESS

Chairperson Munger asked if there was any new business to be brought before the Board. Executive Secretary Blair referred the Trustees to a resolution to be presented to Trustee Ousley in recognition of her service to the Board. Trustee Latoza moved for adoption of the resolution and Trustee Fanti seconded the motion. All present were in favor.

ADJOURNMENT

There being no further business to be brought before the Board, the meeting adjourned at 11:55 a.m. Comptroller Munger thanked the Trustees and reminded them the next meeting is scheduled for April 19, 2016, at 10 a.m. in the Springfield Office and the videoconference location in the Bilandic Building.

Leslie Geissler Munger, Chairperson

Date: _____

ATTEST:

Timothy Blair, Executive Secretary

Date: _____