

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF TRUSTEES

January 10, 2017

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, January 10, 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-600, 160 North LaSalle Street, Chicago, IL.

The following trustees were in attendance:

David Morris, Vice-Chairperson
Tad Hawk, Elected Active Trustee
Robert Fanti, Elected Active Trustee
Stephen Mittons, Elected Active Trustee
Alan Latoza, Elected Retired Trustee
Renee Friedman, Appointed Trustee
Thomas Allison, Appointed Trustee
Danny Silverthorn, Appointed Trustee

Absent:

Susana A. Mendoza, Chairperson
Yasmin Bates-Brown, Appointed Trustee
Carl Jenkins, Appointed Trustee
John Tilden, Elected Retired Trustee

Others in attendance were:

Timothy Blair, Executive Secretary
Jeff Houch, Assistant to Executive Secretary
Steve Bochenek, System Attorney
Rick Cornell, Illinois Office of the Comptroller
Kevin Schoeben, Illinois Office of the Comptroller (by phone)
Lauren Peters, Illinois Office of the Comptroller (by phone)
William Atwood, Director, Illinois State Board of Investment
Alex Rivera, Consulting Actuary, Gabriel, Roeder, Smith & Co.
Ryan Gunderson, Consulting Actuary, Gabriel, Roeder, Smith & Co.
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 Office
Jennifer Staley, Recording Secretary
Jessica Blood, Recording Secretary
Loren Iglarsh, SERS Retiree

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

PUBLIC COMMENTS

Vice-Chairperson Morris 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.

INTRODUCTION AND REPORT OF CHAIRPERSON MENDOZA

Rick Cornell of the Comptroller's Office stated that Comptroller Mendoza was unable to attend, but was very interested in the business of the Board. He expressed the Comptroller's commitment to participate in meetings and that her office would continue to work with SERS and staff on common issues.

Vice-Chairperson Morris asked about the priority of making the required State contributions. Mr. Cornell advised that the payments would continue to be a priority and that there would be ongoing communications and cooperation between the staff of SERS and the Comptroller's Office. Vice-Chairperson Morris then asked about the appointment of Loren Iglarsh as Comptroller Mendoza's designee to the Executive Committee. Mr. Cornell committed to ensuring a designee would be appointed in a timely manner.

MINUTES OF THE OCTOBER 27, 2016 BOARD MEETING

The minutes of the Board meeting held on October 27, 2016, were presented to the members by Vice-Chairperson Morris. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Fanti 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, 2016, prepared by Metketa Group. He began by reviewing the returns of the various asset classes for the nine months ending September 30, 2016, noting the entire portfolio returned 5.8% (net of fees) over the period, matching the benchmark. The Fixed Income portfolio returned 5.3%, net of fees, over the same period, underperforming the benchmark return of 6.7%.

Mr. Atwood continued by reporting the U.S. Equity portfolio returned 7.4%, net of fees, over the 9 months ended September 30, 2016, lagging the benchmark return of 8.2%. He reported the Hedge Fund of Funds portfolio lost 2.4% over the nine month period, while the custom benchmark lost 0.2%, and noted ISBI is reducing the Hedge Fund Allocation by transition funds to other asset classes. Responding to a question by Trustee Friedman, Mr. Atwood stated the shift of assets from Hedge Funds is a lengthy process due to contractual obligations.

Mr. Atwood concluded his review of asset classes by reporting the Non-U.S. Equity portfolio returned 5.9% (net of fees) over the nine months ended September 30, 2016, slightly lagging the benchmark return of 6.1%. He then reminded the Board that ISBI is shifting assets within the Equity and Fixed Income portfolios to passive management, with the percentage of total assets moving from 44% passively managed at September 30, 2016, to almost 50% passively managed at December 30, 2016.

Mr. Atwood asked if there were any questions on the portfolio review. Trustee Allison asked about the volatility in the annual ISBI return rankings when compared to other public retirement systems' net returns. Mr. Atwood answered the return assumption had been reduced several times and asset allocations had been changed. In addition, at times the portfolio was better positioned for certain market conditions.

Vice-Chairperson Morris asked about the impact of regular monthly employer contributions on the rate of return and noted that prior to Comptroller Topinka the system would go months without a contribution and had to withdraw significant amounts to pay monthly benefits. Mr. Atwood answered the liquidity needs are very important in constructing the portfolio and that ISBI works closely with SERS staff in predicting those needs on an annual basis. He added that during the 2008 financial crisis, the State borrowed the employer contribution and funded SERS with bond proceeds. There were years when assets from the investment portfolio were needed to pay benefits for several months, with the assets being sold into a down market.

Mr. Atwood asked if there were any additional questions. There being none, Trustee Hawk moved to approve the ISBI Quarterly Review for the period ending September 30, 2016. Trustee Silverthorn 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. Vice-Chairperson Morris thanked Mr. Atwood for his report and excused him from the remainder of the meeting.

REPORT OF CONSULTING ACTUARIES

Alex Rivera and Ryan Gunderson, Consulting Actuaries, Gabriel, Roeder, Smith & Company, distributed documents to review.

State Actuary's Report. Mr. Rivera first referred to the State Actuary's report, which concluded the assumptions and methodology used for the FY 2016 valuation are reasonable and that the certified contributions were calculated in accordance with State law. He noted the State Actuary again recommended SERS complete a full replication actuarial audit. Mr. Blair advised staff was preparing a Request for Proposal (RFP) to find an actuarial firm to perform the actuarial audit. He added the Commission on Government Forecasting and Accountability (CoGFA) annually prepares a parallel valuation of the SERS valuation, using SERS' membership data, assumptions and methodology.

Trustee Friedman asked about the potential cost of an actuarial audit. Mr. Blair noted the cost is not yet known but added that \$60,000 was included in the FY 2017 administrative budget for the audit. Trustee Friedman asked if the State Actuary could perform the audit. Mr. Blair noted the law could be changed to require the State Actuary to perform the audit, and Mr. Rivera added that independence could be a concern.

Mr. Rivera continued his report by pointing out the State Actuary again suggested changing the statutory funding method in order to avoid continued systematic underfunding. He noted that GRS and the System agree and reminded the Board of the actuarial funding policy adopted by the Board. Trustee Allison added that the Board had a memo from the System's attorney outlining the reasons the Board could not alter the statutory funding plan.

Mr. Rivera continued by adding the stress testing had been added to the valuation at the recommendation of the State Actuary. He briefly reviewed the stress testing scenarios and

methodology in response to questions from Trustees Allison and Friedman. Vice-Chairperson Morris asked if the actuaries could determine the impact of inadequate employer contributions historically. Mr. Rivera answered the impact could be measured and Mr. Blair briefly reviewed the various statutory funding plans adopted by the State over the past several decades. Mr. Rivera concluded his review of the State Actuary's recommendations by noting GRS agrees with the recommended annual review of the economic assumptions.

Trustee Allison asked Mr. Rivera if separately funding Tiers 1 and 2 could be implemented by the Board or if it would require a change to the statutory funding plan. Mr. Rivera responded a statutory change would be required to fund the tiers separately. Mr. Blair added that the funding change would result in an increase in required State contributions for the next few years, but would decrease the total amount of required State contributions over the 28 years remaining in the current funding plan. After further discussion, the consulting actuaries were directed to prepare actuarial projections of the impact of funding the tiers separately.

FY 2018 State Contribution Certification. Mr. Rivera presented and reviewed the documents that will be used to certify the FY 2018 State contribution of \$2,413,347,000, or 54.013% of projected payroll, including \$85,698,000, or 1.918% of payroll, for the debt service on the pension obligation bonds issued in FY 2003. Trustee Fanti moved to certify the FY 2018 employer contribution as presented. Trustee Hawk seconded the motion and it passed unanimously. Vice-Chairperson Morris asked if there was a motion to approve the FY 2016 actuarial valuation. Trustee Hawk moved to approve the valuation and Trustee Silverthorn seconded. All present voted in the affirmative.

REPORT OF ANY TRUSTEE

Vice-Chairperson Morris asked if any trustee would like to offer a report. None did.

REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Ethics Training. Gerry Mitchell, CISO and Ethics Officer, told the Board that the Secretary of State had notified him regarding the schedule for the completion of the 2017 Statements of Economic Interest. Just like 2016, the distribution of statements will take place in early March.

Systems Modernization. Mr. Mitchell noted the systems modifications from quality assurance testing are completed on the pension setup process, and the development and testing of the new service purchase system are underway. In addition, he reported on the training of 80 retirement coordinators on the additional functionality of the employer website and the continuing move to implement Office 365. Among other functionality improvements, Office 365 will allow staff to distribute Board material to Trustees through the website and allow for easier encryption of emails.

MyBenefits System Issues. Mr. Mitchell reminded the Board of the recent implementation of a new MyBenefits insurance system by CMS. He noted that many problems continue and there is an ongoing lack of progress and poor communication from CMS and the vendor, and the SERS IT Division continues to make system modifications due to the ongoing problems. Mr. Mitchell added that a security flaw had been found in the new system and had been corrected, but that requested basic disaster recovery information had not yet been provided by CMS or the vendor.

REPORT OF AUDIT & COMPLIANCE COMMITTEE

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 the full report to the Board.

Mr. Evans began by introducing new Internal Auditor Stacey Cabey-Kauffman to the Board and noted she had transferred to SERS from the Illinois Department of Transportation. He continued by noting the external Financial Audit was almost complete and appeared that there would be one material finding. CIA Evans also stated the external auditors have indicated the FY2016 financial statements were fairly presented. Mr. Evans continued his report by noting recent and ongoing internal audits, including a review of the 70½ required minimum distribution process and an analysis of Alternative Retirement Cancellation Payment (ARCP) repayments. He concluded his report by offering to answer questions. There were none.

REPORT OF RULES AND PERSONNEL COMMITTEE

Trustee Latoza reported the Rules and Personnel Committee had met on Monday, January 9, 2017, at 2 p.m. in the System's Springfield Office. He noted the Committee is comprised of Trustees Silverthorn, Fanti and Latoza and is staffed by Jeff Houch, Assistant to the Executive Secretary. He then turned the report over to Mr. Houch, who reported the proposed rules are likely to be acted upon by the Joint Committee on Administrative Rules (JCAR) in February.

Mr. Houch reported the proposed rules deal with the administration of disability benefits, the IRS' age 70½ required mandatory distribution, and the suspension of hardcopy checks when members fail to cash benefit checks. In addition, the proposed rules reflect changes in the Freedom of Information Act (FOIA) as recommended by JCAR. He offered to answer questions. None were offered.

REPORT OF THE EXECUTIVE SECRETARY

FY 17 Funding Update. Mr. Blair noted that all FY 2017 employer contributions had been made through January, but that the February contribution may be delayed, as February is historically the worst month for State revenues. Vice-Chairperson Morris asked if the system still minimized the amount of cash on hand to discourage the state from borrowing from SERS. Mr. Blair answered in the affirmative and noted the cash balance is usually maintained in the range of \$200 million in order to meet benefit payroll.

FIRST QUARTER FINANCIAL STATEMENTS

Alan Fowler, Accounting Division Manager, presented the financial statements for the first quarter of FY 2017. Mr. Fowler began his report by noting that in comparison to the prior quarter employer contributions decreased by \$135.3 million, due primarily to the timing of the release of GRF contributions by the Comptroller's Office. When compared to the corresponding quarter from the prior year, the decrease in employer contributions was \$18.2 million and was again primarily due to the timing of the release of GRF payments. Mr. Fowler concluded his report by offering to answer questions. There were none.

APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the October and November 2016 Executive Committee minutes for review. There being no changes to the minutes, Trustee Fanti moved to approve. Trustee Latoza 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. Mr. Blair announced the retirement of Jennifer Staley on December 31, 2016 and introduced Jessica Blood, Administrative Assistant, to the Board. He noted that Jennifer would continue to work during the period of transition and that Jessica had previously worked at SERS in the Administrative Services Division. He concluded by also welcoming new Internal Auditor Stacey Cabey-Kaufmann to SERS.

ADJOURNMENT

There being no further business to be brought before the Board, the meeting adjourned at 12:10 p.m. Vice-Chairperson Morris thanked the Trustees and reminded them the next meeting is scheduled for April 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: _____