

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

**MINUTES OF THE REGULAR MEETING
OF THE BOARD OF TRUSTEES**

July 17, 2012

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, July 17, 2012, at 10:00 a.m. in the System's Springfield office located at 2101 South Veterans Parkway with videoconference location at the Bi-landic Building, Room N-703, 100 West Randolph Street, Chicago, IL.

The following trustees were in attendance:

Judy Baar Topinka, Chairperson
Lori Laidlaw, Vice Chairperson
Thomas Allison, Trustee
Shirley Byrd, Trustee
Renee Friedman, Trustee
David Morris, Trustee
Michael Noser, Trustee
Patricia Ousley, Trustee
Patricia Rensing, Trustee
Virginia Yates, Trustee

Absent:

Harold Sullivan, Jr., Trustee
Danny Silverthorn, Trustee

Others in attendance were:

Timothy Blair, Executive Secretary
Dave Rolf, Attorney
Charles Hagopian, Office of the Comptroller
William Atwood, Director, Illinois State Board of Investment
Gerald Mitchell, Chief Information Systems Officer
Loren Iglarsh, Executive Committee Chairman
Dave O'Brien, Manager, Administrative Services Division
Nicholas Merrill, Manager, Accounting Division
Alexis Sturm, Office of the Comptroller
Barbara Baird, SERS Chicago Office
Alice Johnson, Nurses Association
Dawn Blakeman, Recording Secretary

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

REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT (ISBI)

William Atwood, Director of ISBI distributed draft copies of the Flash Report (Executive Summary) for the period ending May 31, 2012, and addressed the Board. Mr. Atwood called attention to the portion of the report reflecting a -2.0% return for the total portfolio for FY 12 year to date, compared to a custom benchmark return of -2.3%. Mr. Atwood then briefly reviewed the performance of the various asset classes. Over the same time period, the fixed income and U.S equity portions of the portfolio returned 5.9% and -2.0%, respectively, with both asset classes underperforming the benchmark.

Mr. Atwood pointed out the hedge fund and non-U.S. equity portfolios lost 4.5% and 15.2% in the fiscal year to date, respectively. Even though these asset classes provided negative returns, both significantly outperformed their benchmarks. Mr. Atwood told the Board he expected that after taking into account June returns, the total FY 12 return will probably be 0.2%. In addition, he does not see a “breakout” in the financial markets and is concerned they may be heading in the opposite direction.

Director Atwood reviewed for the Board various concerns of the ISBI. He mentioned ISBI will review the use of hedge funds of funds and whether there are alternatives to the current approach. In this review, the ISBI has instructed staff to approach hedge fund of funds managers about reducing the management fees of ISBI. After hearing back from the managers, Director Atwood expects action at the September ISBI meeting.

Regarding the fixed income portfolio, Mr. Atwood informed the Board that ISBI is looking at the fixed income portfolio and seeking opportunities to increase yield during a prolonged period of low interest rates. In addition, McDonnell, with an allocation of \$160 million, was recently purchased and Mr. Atwood opined the move may not be in the best interest of ISBI. Given that, the Board is considering releasing a Request for Proposal (RFP) for a fixed income manager to invest the \$160 million currently managed by McDonnell.

Mr. Atwood told the board he has discussed with various industry professionals the recent London Interbank Offered Rate (LIBOR) scandal. The area of the portfolio with the most exposure to the LIBOR scandal is bank loans. ISBI staff is talking to the affected managers about the impact on the ISBI portfolio. Mr. Atwood expressed frustration in the fact that most managers are viewing the scandal as a minor issue, even though trillions of dollars are involved. He expects unraveling the issues will be a long term process.

Following Mr. Atwood’s remarks, Trustee Friedman requested that in the future the ISBI provide the SERS Board with a “net of fees” report that tracks the Flash Report. After a brief discussion, Mr. Atwood agreed to provide the requested information. Trustee Friedman further requested the S&P 500 index be included in future ISBI reports to the SERS Board.

Trustee Noser asked Mr. Atwood’s opinion on the likelihood of achieving the long term SERS rate of return assumption of 7.75% in the current level or declining market environment. Mr. Atwood responded by pointing out that during periods of very low inflation it would be difficult to achieve a 7.75% annual return, as the real return provided by the portfolio would have to increase significantly. He provided that if the investment return assumption includes an inflation component of 3%, it also includes a real return component of

4.75%. If inflation is only 1%, the real rate of return must be 6.75% in order to match the 7.75% return assumption. Because of the low inflation rate, Mr. Atwood opined the chances of the current ISBI portfolio achieving a 7.75% rate of return are not great.

Mr. Atwood further explained the market conditions have changed drastically since the adoption of the current asset allocation model by ISBI. Thus, a lower interest rate assumption could be considered or asset allocations could be changed. But, if there is a significant turnaround in the market, the ISBI needs to be positioned to participate fully in the upside.

Trustee Allison continued the discussion by pointing out that the actuaries contend a wide range of return assumptions are considered within the "range of reasonableness" and asked Mr. Atwood what he would consider the correct assumption. Mr. Atwood responded that he considers a return assumption of 4.75% above the rate of inflation to be reasonable. Trustee Allison followed up by pointing out that he didn't know if the actuaries could do the required calculations based on a return assumption of expected inflation plus 4.75%.

Mr. Atwood continued by noting that a 7.75% investment return assumption is right in the middle of assumptions currently in use by peer plans, although he would have thought it would be at the top of the range. Trustee Allison then pointed out that SERS led the way in Illinois in lowering the assumption to 7.75% and reminded the Board that at the time there was interest in looking at the propriety of reducing the assumption to 7.5% at some point in the future if it is warranted.

Following further discussion on the investment return assumption, Trustee Noser moved to accept the ISBI Flash Report for the period ending May 31, 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 thanked Director Atwood for his report and excused him from the remainder of the meeting.

MINUTES OF APRIL 17, 2012 BOARD MEETING

The minutes of the meeting of the Board of Trustees held April, 17, 2012 were presented to the members by Chairperson Topinka for approval. Trustee Ousley moved to approve the minutes as submitted. Trustee Rensing seconded the motion, and all were in favor.

REPORT OF THE CHAIRPERSON

Chairperson Topinka indicated she had no formal report, but stated she would like Executive Secretary Blair to discuss recent complaints filed pertaining to SB 1313, which increased the health insurance premiums for SERS retirees. Executive Secretary Blair informed the Board that he was aware of two complaints, one by retired Appellate Court Justice Gordon Maag, which had been filed pertaining to the increase in health insurance premiums. As they were recently filed, he told the Board that he had not reviewed the complaints but would do so and provide more details to the Board.

REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Gerry Mitchell, CISO of SRS, provided an update on the System's modernization efforts and other activities. Phase two of the modernization of the active member system continues with improvements implemented that makes payroll posting and editing easier. This phase will also include components that make it much easier for the employees to look at data. In addition, a "bridge" has been created that will allow the legacy system and new system to communicate. Mr. Mitchell told the Board this has been a difficult process.

Mr. Mitchell continued by informing the Board the imaging system has been integrated with the active member system, allowing staff a more user-friendly environment. As part of this integration, the various documents used to communicate with members will be generated with indexing bar codes for easier input into the imaging system.

Mr. Mitchell provided an update on the imaging project. The backfile conversion continues with 10 of the 21 lektrievers empty due to the paper files being converted to images. He expects the conversion of all paper files to be completed by the end of the calendar year, but the fiche conversion tends to be more a problem due to more manual processes being involved in the conversion. Mr. Mitchell noted the great job done by Dave O'Brien and his staff in managing the backfile conversion and keeping the project on track.

Mr. Mitchell informed the trustees that staff has been meeting with CMS regarding implementation of SB 1313, which increases retiree health insurance premiums. This change will require significant changes to the current processes at SERS and CMS. Rather than CMS just providing a "screen" for SERS to enter data, there will be a need for the two agencies to interact more and exchange data. Mr. Mitchell expressed concern that CMS is trying to move very quickly and he wants to ensure the new functionality is adequately tested and implemented correctly as it affects 50,000 SERS retirees.

Trustee Rensing pointed out the SB 1313 impact on retirees is currently being negotiated between the State and AFSCME and she doesn't feel the need to "fast track" the implementation when there are so many unknowns. Mr. Mitchell answered the actual timetable for implementation is unknown, but that SERS wants to have the IT systems ready for the significant changes in processing.

Trustee Rensing inquired how SERS could prepare to implement the insurance changes when the costs are unknown. Mr. Mitchell agreed, but CMS, as the administrator of the Group Health Insurance Program, has informed the State-funded retirement systems they must be prepared to implement the insurance changes within 90 days. Trustee Rensing questioned with all of the unknowns associated with SB 1313, what unknown resources was SERS willing to commit. Mr. Mitchell responded he didn't know.

Trustee Morris then explained the current insurance structure for retirees and that retiree insurance premiums are deducted from the retirement checks. He pointed out that at some point the premium rates will be determined and the program established. Secretary Blair pointed out that SERS is the payroll office for 50,000 retirees. He explained that currently SERS calculates the health insurance premiums that are to be deducted from retirement checks and noted the vast majority of retirees have more than 20 years of service credit and therefore are not required to pay premiums for their own health insurance. And

for those who are required to pay a portion of the premium, the calculation is pretty simple. With the passage of SB 1313, as administrator of the group health insurance program, CMS will calculate retiree health insurance premiums and provide them to SERS through a data exchange process.

Executive Secretary Blair further explained the IT staff is trying to ensure that whatever happens with SB 1313 implementation as far as timing, the goal is to try to minimize the impact on retirees, who are already going to be greatly impacted by these changes.

Trustee Noser asked Trustee Rensing if the System should be doing something differently. Trustee Rensing responded by pointing out that there are so many unknowns regarding the health insurance changes, and maybe the System should slow down, as she felt the re-engineering is falling behind. As the formula for determining premiums will not be complicated, maybe resources would be better used in the continuing backfile conversion and the bridge between the technologies, rather than getting bogged down with CMS, as they are not known for being efficient. And, with the ongoing negotiations, there will be plenty of time for implementation.

Mr. Mitchell continued his report by explaining the infrastructure technology needed for SERS to host the website has been procured, installed and configured. There will be a security assessment with someone brought in to try to “hack” the new site and technology. Trustee Morris asked Mr. Mitchell to explain how the website will be used to enhance customer service. He responded by pointing out that the system has three groups who could benefit greatly from an enhanced website; active and retired members, reciprocal systems and retirement coordinators at the various agencies.

Mr. Mitchell reported the System has almost completed the updated disaster recovery plan and has tested the IT portion of the plan. There were problems during the first test but the testing will continue. In addition, in order to try to meet the 5 day recovery requirement of the agency, “hot site” options have been explored. SunGard has provided a cost of approximately \$5,000 per month to maintain a site for SERS. CMS’ Northern Data Center in Oak Brook offers the same services for around \$2,000 per month. Mr. Mitchell recommended utilization of the CMS site, due to the lower cost and the desirability of spending the money with a State agency. There may also be an advantage if there are any technical issues, as all parties involved work for the State and there is no profit motive.

Trustee Allison asked if there was any danger in having another State agency being the “backup” for SERS during a disaster. Mr. Mitchell explained that the location of the “hot site” in Oak Brook is meant to provide security against a disaster that could affect the entire city of Springfield. Effectively, our equipment would be in Oak Brook and available for our use. The equipment would be dedicated to our use and could be remotely accessed during an emergency. After a brief discussion, Trustee Morris made a motion to use the CMS Northern Data Center as the System’s “hot site.” Trustee Yates seconded the motion and all were in favor.

THIRD QUARTER FINANCIAL REPORT

Nicholas Merrill, Manager of the Accounting Division, presented the financial reports for the 3rd quarter of FY 12. Regarding receipts, Mr. Merrill noted the employer contribu-

tions in FY 12 have been more timely and predictable and SERS did not have to transfer assets from the ISBI to pay benefits during the third quarter. But, with the unusually large number of retirements during FY 12, with total retirees reaching 50,000, benefit payments will increase in FY 13.

Chairperson Topinka asked Mr. Merrill if he expected the increase in retirements to continue into FY 13. He responded that he expects retirements to level off until there is more information about proposed changes to retirement benefits and retiree health insurance premiums. Trustee Morris added that upcoming layoffs and facility closures may increase retirements as people who are eligible to retire may do so in lieu being laid off or transferring to another agency.

On motion by Trustee Rensing, seconded by Trustee Ousley, and by unanimous vote, the Board approved the financial reports as presented for the period January 1, 2012 through March 31, 2012. Copies of the financial reports are attached as Exhibit B.

REPORT OF EXECUTIVE SECRETARY

Final Review of FY 13 Budget

Executive Secretary Blair presented the final proposed budget for the fiscal year July 1, 2012 through June 30, 2012 for the Board's consideration. Copies of the executive summary, as well as a detailed budget, were provided to the trustees for review prior to the meeting. The proposed operating budget for FY 13 includes the continuation of the imaging project and represents a decrease of \$682,800 from the preliminary budget approved in April. The proposed FY 13 budget totals \$20,680,600, or 10.27% more than the FY 12 budget amount of \$18,755,300.

The proposed FY 13 budget for Personal Services increased by \$24,600 from the April preliminary budget. A \$50,000 proposed increase in overtime was partially offset by the removal of \$25,400 for merit compensation employee raises that had been approved at the April Board meeting. The overtime request has increased since April due to the possibility of the continuation of large numbers of retirements. The July budget request includes increases in the Employer Retirement line (\$9,400) and the FICA line (\$4,900) due to the requested increase in the Personal Services budget.

The Printing budget request for FY 13 was increased by \$58,500 from the preliminary April budget due to a formal Interagency Agreement (IAG) between the Illinois Department of Human Services (DHS) and SERS. Prior to the IAG, there was an informal agreement whereby SERS reimbursed DHS for certain printing supplies. The IAG requires, for the first time, SERS to pay to DHS the cost of printing newsletters and other Agency materials.

The Contractual Services budget request increased \$209,800 from the approved April preliminary budget. Included in that total is an increase of \$110,000 for the backfile conversion project. The microfiche conversion portion of the contract had to be amended due to the poor condition of the microfiche and microfiche sleeves, requiring the vendor to implement a labor-intensive process to film the microfiche. Executive Secretary Blair informed the Board that even with the requested increase, the expected cost of the backfile conversion is still below the next lowest bid that was submitted for the project.

The Contractual Services budget also includes a requested increase of \$63,600 for actuarial services. The System spent more than budgeted for actuarial services in FY 12, primarily due to the actuarial projections prepared during the legislative discussion of possible changes to SERS benefit provisions. As the discussion on possible benefit changes continues, the FY 13 final budget request includes the estimated cost of additional actuarial work.

Trustee Rensing asked if the backfile conversion was part of a Personal Services Contract (PSC) with deadlines. Executive Secretary Blair explained the system generally uses 75 day temporary employees, rather than entering into PSCs. There is one temporary employee in Claims to help process retirement applications and one in Field Services to train her replacement. Trustee Rensing asked if the temporary help outlined is something different than the backfile conversion. After Executive Secretary Blair attempted to answer the question, Dave O'Brien, Administrative Services Division Manager, offered the \$37,000 contract included in the budget request is for Janie Taft, a recent SERS retiree, to assist the Claims Division in the processing of the unusually large number of retirement applications.

The FY 13 IT budget request decreased by \$1,000,300 from the preliminary budget approved by the Board in April. The elimination of several consultants for the modernization process (\$890,000 reduction) and the elimination of a proposed satellite office for future IT employees (\$193,000 reduction) were the primary reasons for the requested reduction. The addition of a \$75,000 production printer offset and the rental of 10 workstations offset a small portion the consultant/satellite office savings. Chairperson Topinka asked about the usage of the soon-to-be vacant Lektriever space. Executive Secretary Blair explained that timing would be an issue but that he believes there will be space identified in the building for any additional IT employees.

Executive Secretary Blair briefly noted a \$3,700 decrease in the Automotive budget request for FY 13 due to the conversion of all assigned Field Service Division vehicles to pool use. He then recapped the final budget request for FY 13 is \$682,800 lower than the preliminary FY 13 budget approved at the April meeting.

Regarding the workstations, Vice Chairperson Laidlaw inquired about the rental of the 10 tech workstations and if the \$13,000 in the budget was for one or all 10. Secretary Blair answered that the workstations are basically cubicles and the \$13,000 request is the rental price for 10 workstations for one year. In response to a question, Mr. O'Brien estimated the purchase price of the workstations to be more than \$7,000.

Vice-Chairperson Laidlaw further pointed out the final FY 13 budget request eliminates raises for 11 merit compensation employees but contains funding for rental of workstations and remodeling the SRS lobby. She stated these employees have been working very hard in the modernization effort and have been greatly affected by all of the changes passed by the legislature, and they have not been given raises for several years as the financial position of the State has deteriorated. Executive Secretary Blair agreed, and pointed out that he thinks the affected employees know that he and the Board support their efforts, but that nothing can be done about the lack of raises in FY 13, unfortunately, regardless of what happens with the workstations and lobby.

After brief discussion on improvements that have been made in the various work areas of SRS, Trustee Allison asked how long it had been since these 11 employees received a salary increase. Executive Secretary Blair answered that he believed the last raises granted to most merit compensation employees occurred in 2007. Trustee Allison then asked what increases had been provided to members covered by the collective bargaining agreement (CBA) during that time period. Executive Secretary Blair answered he wasn't sure but thought the CBA provided for 13% increases. Trustee Rensing pointed out that the answer was not that simple as there had been employee givebacks and issues are being litigated.

Trustee Noser moved to accept the final FY 13 budget as presented, including the \$15,000 to replace the lobby furniture. The motion died for lack of a second. Chairperson Topinka asked if there was a motion to replace the lobby furniture. No motion was offered. Vice Chairperson Laidlaw presented a motion to approve the final FY 13 budget request as presented, excluding the \$15,000 for new lobby furniture for the Springfield office. Trustee Rensing seconded the motion and all were in favor.

EXECUTIVE COMMITTEE MEETING MINUTES

The Trustees had previously been furnished with copies of the April, May and June, 2012, Executive Committee minutes for review.

Trustee Rensing inquired about the recommendations referenced in the minutes and cited examples. Executive Secretary Blair stated the recommendations are prepared by the System's attorney after a personal hearing and they are considered SRS's final administrative decision to be used during the administrative review process. Trustee Allison asked that those recommendations be include in the Executive Committee minutes and mentioned that he thought it had been done at some point. Trustee Rensing agreed. Executive Secretary Blair promised to include all written recommendations in future Executive Committee minutes.

Trustee Allison made a motion to approve the Executive Committee minutes with the understanding that future Executive Committee minutes would include the recommendations. Vice-Chairperson Laidlaw seconded the motion, which prevailed by the affirmative vote of all trustees.

OLD BUSINESS

There was no old business brought before the Board.

NEW BUSINESS

Trustee Allison asked to be put on the record regarding the recent actuarial RFP and the subsequent approval of Gabriel, Roeder, Smith and Company as the System's actuaries. He would like the Board to be included in the actuarial RFP process in the future, as the actuarial work done on behalf of the Board is very important. Trustee Allison said he is pleased with the current actuaries and he is happy they are continuing as the Board's actuaries, but he does think it is a very important function of SERs and the Board of Trustees should be involved. Executive Secretary Blair agreed to involve the Board in the next actuarial RFP.

ADJOURNMENT

Chairperson Topinka informed the Board the next meeting is scheduled for October 30, 2012. There being no further business to be brought before the Board, Trustee Ousley moved for adjournment at **11:50** a.m. The adjournment motion was seconded by Trustee Rensing and all were in favor.

Judy Baar Topinka, Chairperson

Date: _____

ATTEST:

Timothy Blair, Executive Secretary

Date: _____