

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

July 16, 2013

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, July 16, 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  
Lori Laidlaw, Vice Chairperson  
David Morris, Trustee  
Michael Noser, Trustee  
Patricia Ousley, Trustee  
Patricia Rensing, Trustee

Absent:

Thomas Allison, Trustee  
Shirley Byrd, Trustee  
Renee Friedman, Trustee  
Danny Silverthorn, Trustee  
Harold Sullivan, Trustee  
Virginia Yates, Trustee

Others in attendance were:

Timothy Blair, Executive Secretary  
Steve Bochenek, Attorney  
Michelle Clatfelter, Attorney  
William Atwood, Director, Illinois State Board of Investment  
Paul Wood, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Alex Rivera, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Nicholas Merrill, Manager, Accounting Division  
Alan Fowler, Accounting Division Supervisor  
Staci Crane, Chief Internal Auditor  
Gerry Mitchell, Chief Information System Officer  
Dave O'Brien, Manager, Administrative Services Division  
Loren Iglarsh, Office of the Comptroller  
Alexis Sturm, Office of the Comptroller  
Barbara Baird, Manager, SERS Chicago Office  
Jennifer Staley, Secretary to CISO  
Dawn Blakeman, Recording Secretary

Chairperson Topinka presided and called the meeting to order at 10:10 a.m. Recording Secretary Blakeman took the roll and with only 6 trustees in attendance there was no quorum. Chairperson Topinka noted that all agenda items could still be discussed but that no action could be taken as all actions of the Board require the affirmative votes of 7 members of the Board.

### 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 May 31, 2013, and addressed the Board. He first called attention to the portion of the report reflecting a 7.5% return, gross of fees, for the entire portfolio for calendar year 2013 through May 31. This return compares favorably to the total portfolio benchmark return of 6.5%.

The return for FY 2013 through May 31 was 15.5%, gross of fees, compared to the benchmark return of 13.3%. For the same time period, the Fixed Income portfolio returned 3.8%, while the benchmark returned 2.0%. Director Atwood continued by noting the U.S. Equity portfolio, excluding the Hedge Fund of Funds allocation, returned 24.4% in FY 2013 through May 31, while the benchmark returned 23.1% over the same time period. He then directed the Board to the Hedge Fund of Funds asset class, which returned 13.5% in FY 2013 through May 31, compared to the benchmark return of 10.4%. Over the same time period, the non-U.S. Equity portfolio performed very well, returning 22.2%, while the benchmark returned 19.7%.

Director Atwood informed the Board that changes were made within the current asset allocations of the portfolio at the June ISBI meeting based on a study performed by Marquette and Associates, the Board's investment consultant. Specifically, assets were shifted from conventional long bonds high yield global and emerging market bonds and bank loans. He stated the driving reason is the continued low level of interest rates and the inevitability of an eventual increase in interest rates, which will hurt the value of long term high grade bonds.

In the non-U.S Equity portfolio, Mr. Atwood noted ISBI allocated 3.5% of the portfolio to emerging market equity and within the hedge fund portfolio, ISBI moved to deconstrain the hedge fund managers somewhat by allowing them to use global macro and credit opportunity strategies. He then offered these strategic changes were made to position the portfolio better in a rising interest rate environment and to fully diversify the portfolio, and not to attempt to "gin up" the total return of the portfolio. Mr. Atwood then offered to answer any questions the Board may have.

The report was not adopted, as no quorum was established. 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 informative report and excused him from the remainder of the meeting.

## REPORT OF THE ACTUARY

Review of the 7.75% Interest Rate Assumption. Alex Rivera and Paul Wood of Gabriel, Roeder, Smith & Company presented to the Board a review of the interest rate assumption.

Mr. Wood referred the Board to a handout and reminded them that SERS had adopted the current interest rate assumption of 7.75% (previously 8.5%) for the June 30, 2010 actuarial valuation. This review of the current assumption and the impact of lowering the assumption to 7.5% was requested by the Board at the January 2013 meeting.

Mr. Wood then briefly reviewed the current ISBI asset allocation and the target ISBI allocation and explained the use of various capital market assumptions to develop a "1 year expected rate of return" for the ISBI portfolio of 7.83%. This number represents a one year expected rate of return but does not reflect long-term market volatility. When accounting for volatility over a 30 year period, the probability of exceeding the current assumption of 7.75% over a 30 year period is 38.6%, while the probably of exceeding 7.50% over that time period is 42.9%.

Mr. Wood continued by reviewing the financial effect of changing the assumption from 7.75% to 7.5%. The total employer contributions required through FY 2045 would increase from almost \$94.5 billion to approximately \$97.1 billion, an increase of \$2.6 billion. The increase in the present value of contributions would increase from almost \$28.6 billion to \$30.2 billion, or \$1.6 billion. He then pointed out the increase in the funded ratio is poor under either scenario due to the current statutory funding policy which delays employer contributions.

Mr. Wood informed the Board there was additional financial information in the study and that he would be happy to review this information or answer any other questions they may have. Trustee Morris asked Mr. Wood to confirm that the contributions reviewed in the report were State contributions only. Mr. Wood confirmed.

Trustee Morris followed up by asking if the number of employees and salary levels would affect the amount of contributions made by employees and the state. Executive Secretary Blair explained that employee contributions would increase with unexpected headcount and payroll growth, as would employer contributions. He further explained that currently, headcount is assumed to remain constant but that salaries are expected to grow based on the current adopted salary increase assumptions. Mr. Wood added that after the 2002 ERI, headcount dropped to around 68,000 and was assumed to increase to around 71,000 over the next several years. As the active member population did not increase as expected over that time period, GRS recommended to staff around 2007 that we assume headcount remains flat.

Mr. Wood clarified that in the analysis of the interest rate assumption, the projected increase in employer contributions is solely the result of decreasing the assumption from 7.75% to 7.5%. The estimated amount of employee contributions would not change.

Chairperson Topinka asked if any of the proposed legislative changes had been analyzed by the actuaries. Secretary Blair answered that the actuaries had been working on

the various scenarios as requested by the Conference Committee that was considering the various proposals.

Trustee Noser then asked if it would be best to have at least a 50% probability of achieving the assumed rate of return. Mr. Wood answered that an assumption that falls between a 25% and 75% probability is considered reasonable. Chairperson Topinka thanked Mr. Rivera and Mr. Wood for the presentation and excused them from the remainder of the meeting.

#### MINUTES OF THE APRIL 16, 2013 BOARD MEETING

The minutes of the meeting of the Board of Trustees held April 16, 2013 were presented to the members by Chairperson Topinka. Copies of these minutes were previously provided to each trustee for preliminary review. Approval of the minutes will be held for approval at the October Board meeting.

#### REPORT OF CHAIRPERSON TOPINKA

Chairperson Topinka stated she had nothing to report.

#### REPORT OF ANY TRUSTEE

Chairperson Topinka asked if any other trustee would like to offer a report. No other Trustee had anything to report.

#### REPORT OF CHIEF INTERNAL AUDITOR (CIA)

CIA Staci Crane had provided copies of material to the Board prior to the meeting. She briefly outlined for the Board the documents she had provided to them since the last meeting and offered to answer any questions. CIA Crane referred the Board to the Risk Assessment of the Modernization Project. A significant risk to the ongoing project is the inability to accumulate and maintain adequate IT staff with the skills necessary to complete the project. She noted that there are currently only 2 programmers working on the modernization project rather than the 6 that are needed. She mentioned the option of developing intern positions.

Executive Secretary Blair then noted that he was preparing a document for the Board that would outline the Modernization Project and related issues from the very beginning of the effort to the present. The current pressing risk is the retirement eligibility of current employees. Almost 50% of current SERS employees will be eligible to retire within 6 years. Therefore, Executive Secretary Blair informed the Board that he would like to do whatever was necessary to provide the IT Division with the resources needed to finish the modernization project within 3 to 4 years.

Executive Secretary Blair told the Board that management had met to discuss options on staffing, including using consultants to serve as staff augmentation in certain areas, particularly the .Net environment. He also suggested creating a few intern or trainee positions that would allow SERS to hire recent graduates and have them trained in the .Net technology.

Chairperson Topinka suggested notifying State universities of the need for graduates with Net skills and Trustee Rensing mentioned the possible use of contractual employees if SERS had exhausted all avenues under current labor agreements and there are no acceptable candidates. Executive Secretary Blair responded that contractual employees had been used to complete work on the website and other related projects. Trustee Morris then asked if SERS utilized exit interviews for people who have transferred to other agencies, specifically from IT. Executive secretary Blair responded in the affirmative and said there were various reasons IT Division employees cited for leaving.

## REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Ethics Training Reminder. Gerry Mitchell, SRS CISO, reminded the Trustees to complete the required annual ethics training. He also notified the Board that all employees had completed a Security Awareness Training course and that feedback from many employees had been positive.

Systems Modernization. Mr. Mitchell informed the Board that all payrolls are now being processed through the new system. The pension calculations re-engineering continues and the Workshop web system configuration and testing is completed. Implementation is being planned for September or October.

Security. Mr. Mitchell explained that security has been upgraded and strengthened for the internal network.

Business Continuity/ Disaster Recovery Planning. Mr. Mitchell reported the business continuity planning documents are completed. The system has upgraded to a high speed network and the disaster recovery computer equipment has been installed and tested at an alternate data center in Oakbrook. Also, an IFB has been published for the installation of a generator for the building.

Risk Assessment. Meetings with each Division Manager to discuss risk assessments are ongoing and should be completed by the October Board meeting. Mr. Mitchell said the biggest business risk continues to be the use of Social Security numbers.

## THIRD QUARTER FINANCIAL STATEMENTS

Nicholas Merrill, Accounting Division Manager, presented the financial statements for the third quarter of Fiscal Year 2013. Mr. Merrill noted the significant changes from the second quarter of FY 2013. Specifically, employer (State) contributions increased by \$10 million as a result of an increase in wages subject to retirement. During the same time period, the amount of retirement annuities increase by \$21.6 million, due primarily to an increase in the number of annuitants and the granting of the 3% compounded automatic annual increases in January. Mr. Merrill concluded his presentation by stating that there was no need to transfer funds from ISBI in FY 2013 in order to pay benefits. He then offered to answer questions from the Board.

Trustee Noser inquired about the decrease in IT expenses. Mr. Merrill explained that is mostly due to vacancies (less payroll and related expenses) and a decrease in the amount of overtime. Chairperson Topinka followed up by asking if the amount of overtime would

continue to decrease as the new systems are brought on line. Mr. Merrill voiced his agreement and then introduced Alan Fowler, who was likely to assume the position of Accounting Division Manager.

Trustee Ousley thanked Mr. Merrill for all the hard work he has done for SERS and congratulated him on his upcoming retirement. The remaining trustees present joined Trustee Ousley in thanking Mr. Merrill for his years of hard work and dedication to SERS. Copies of these financial statements are attached to these minutes as Exhibit B.

### REPORT OF THE EXECUTIVE SECRETARY

Final Review of FY 2014 Budget. Executive Secretary Blair presented the proposed FY 2014 budget for review. Copies of the executive summary, as well as the detailed budget, were previously provided to the trustees for review prior to the meeting.

The preliminary FY 2014 operating budget of \$21,325,200 was approved at the April Board meeting. This amounted to an increase of 3.19%, or \$659,600, more than the FY 2013 budget amount of \$20,665,600. The July request was for an additional net amount of \$1,300, resulting in total requested increase of 3.2%, or \$660,900, more than the FY 2013 budget amount. The final budget request will be presented at the October Board meeting due to the lack of a quorum.

Administrative Procedures Act. Executive Secretary Blair asked Attorney Michelle Clatfelter to review the July 16<sup>th</sup> memo pertaining to the proposed changes to the Executive Committee. Specifically she outlined the implementation of a prehearing conference that should allow most member appeals to be settled prior to a formal hearing and then reviewed a flow chart outlining the steps that would ultimately lead to a formal hearing that would comply with the Administrative Procedures Act, including the use of an Administrative Law Judge and a Court Reporter.

Fiduciary Insurance Update. Executive Secretary Blair notified the Board that the same fiduciary liability coverage was renewed with a reduced premium of \$349,000 annually, rather than previous annual premium of \$509,000.

### APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the January, February and March 2013, Executive Committee minutes for review. Due to the lack of a quorum, these minutes will be held for consideration at the October Board meeting.

### OLD BUSINESS

There was no old business to review.

### NEW BUSINESS

Trustee Morris asked to be provided with information on the number of employees in each Department who are currently eligible to retire and those are eligible to retire within

the next five to seven years. Executive Secretary Blair offered to compile and provide the requested information to all trustees.

ADJOURNMENT

There being no further business to be brought before the Board the meeting was adjourned at 12:30 p.m.

\_\_\_\_\_  
Judy Baar Topinka, Chairperson

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

ATTEST:

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

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