

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE REGULAR MEETING  
OF THE BOARD OF TRUSTEES

July 25, 2017

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, July 25, 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-703, 160 North LaSalle Street, Chicago, IL.

The following trustees were in attendance:

Susana Mendoza, Chairperson  
David Morris, Vice-Chairperson  
Thomas Allison, Appointed Trustee  
Yasmin Bates-Brown, Appointed Trustee  
Shaun Dawson, Elected Active Trustee  
Renee Friedman, Appointed Trustee  
Tad Hawk, Elected Active Trustee  
Carl Jenkins, Appointed Trustee  
Alan Latoza, Elected Retired Trustee  
Stephen Mittons, Elected Active Trustee  
Danny Silverthorn, Appointed Trustee  
John Tilden, Elected Retired Trustee

Absent:

None

Others in attendance were:

Timothy Blair, Executive Secretary  
Jeff Houch, Assistant to Executive Secretary  
Steve Bochenek, System Attorney  
Chris Maley, Illinois Office of the Comptroller  
Chasse Rehwinkel, Illinois Office of the Comptroller  
William Atwood, Director, Illinois State Board of Investment  
Alex Rivera, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Ryan Gunderson, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Alan Fowler, Manager, Accounting Division  
Casey Evans, Chief Internal Auditor  
Staceyann Cabey-Kaufmann, Internal Auditor  
Barbara Baird, Manager, SERS Chicago Office  
Jessica Blood, Recording Secretary  
Loren Iglarsh, SERS Retiree

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

PUBLIC COMMENTS

Chairperson Mendoza 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 APRIL 25, 2017 BOARD MEETING

The minutes of the Board meeting held on April 25, 2017 were presented to the members by Chairperson Mendoza. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Latoza moved to approve the minutes as submitted. Trustee Hawk 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 dated March 31, 2017. He began by his report by comparing the actual asset allocation and target policy allocation, noting that the Fixed Income Composite amounted to 28.8% of the portfolio, slightly under the policy target of 30%. Director Atwood added that the U.S. Equity Composite equaled 29.4% of the portfolio, considerably higher than the policy target of 23%, noting that this overweighting will be reduced by transferring some of these assets to the private equity portfolio.

Director Atwood added that the Hedge Fund of Funds Composite was 5% of the portfolio at March 31, 2017, but today is closer to the policy target of 3%. He then noted for the Board that the Non-U.S. Equity Composite was slightly overweighted at 20.2% of the portfolio (target of 20%), the Real Assets Composite was underweighted at 13% of the portfolio (target of 15%) and the Private Equity Composite was underweighted at 3.3% of the portfolio (target of 9%), reminding the Board that assets would be transferred from the U.S. Equity portfolio to achieve the higher policy target of 9%.

Director Atwood continued his report by reviewing the performance of the investment portfolio and the various asset classes for the nine months ended March 31, 2017. He pointed out that over this period the total fund composite return of 8.2% slightly lagged the benchmark return of 8.4%. He added that the Fixed Income portfolio lost 0.5%, slightly ahead of the benchmark loss of 0.6%, while the High Yield Fixed Income portfolio returned 8.4%, lagging the benchmark return of 10.3%.

Director Atwood continued his asset class performance review by noting the U.S. Equity portfolio returned 15.5%, well ahead of the benchmark return of 15.0%, and the Non-U.S. Equity portfolio returned 14.9%, also well ahead of the benchmark return of 13.8%. He added the Real Assets portfolio returned 3% compared to the benchmark return of -0.6%. He added the Real Estate portfolio returned 3.5%, significantly lagging the benchmark return of 5.8%, and the Private Equity portfolio returned 5.7% while the benchmark returned 10.7%.

Director Atwood next reported on the usage of minority and female owned brokerage firms for the nine months ended March 31, 2017. He stated that 51.9% of U.S. Equity trades were done through minority and female owned brokerage firms, surpassing the goal of 30%. In addition, International equities utilization was 21.1%, surpassing the goal of 20%, and International Fixed Income utilization was 2.5%, with the goal of 0-5%. Hedged Equity utilization was 36%, significantly surpassing the goal of 0-5%. Director Atwood concluded that the 24.5% of the portfolio was managed by minority or female owned investment managers.

Director Atwood informed the Board that several changes were made at the June 30, 2017 ISBI Board meeting. He stated that Rock Creek manages the hedge fund portfolio

while Hamilton Lane has a consulting relationship on the private equity portfolio. With Portland Advisors having resigned their ISBI account on May 31, 2017, ISBI chose to allocate portions of the real estate portfolio to Rock Creek and Hamilton Lane and to allow Hamilton Lane the same discretionary authority over the private equity portfolio as Rock Creek has over the hedge fund portfolio. He noted that ISBI Board and staff would still be closely monitoring the selection of individual managers and the portfolio operation of Rock Creek and Hamilton Lane.

Director Atwood added that ISBI staff is preparing a request for proposal to consider a third strategic relationship to be considered by the Board's and stated that Meketa had also presented some suggested changes to asset allocation, including lowering the private equity goal and eliminating the hedge fund allocation.

Director Atwood concluded by reporting that Johara Farhadieh had been promoted to Chief Investment Officer and would be responsible for the daily management of the portfolio, operations and investment policy. He concluded his report by noting the Board had two new members, Katherine Hennessy and Stacey Woehrle and offered to answer questions.

Chairperson Mendoza asked if there were any questions for Director Atwood regarding the report. There being none, she asked for a motion to adopt the ISBI Quarterly Review. Trustee Silverthorn moved to adopt the ISBI Quarterly Review for the period ending March 31, 2017. Trustee Jenkins seconded the motion and it passed unanimously. A copy of this report is maintained in the ISBI office and made a part of these minutes as *Exhibit A*.

#### REPORT OF CONSULTING ACTUARIES

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

Actuarial Assumption. Mr. Rivera began the review by referring the Trustees to the Economic Assumption Update Review for the June 30, 2017 Actuarial Valuation, which concluded with the recommendation of maintaining the same assumptions used for the June 30, 2016 valuation, including an annual investment return assumption of 7%, annual price inflation of 2.75% and annual wage inflation of 3.25%.

He noted the investment return assumption review was based on asset allocation and capital market assumptions that were developed by Meketa Investment Group, ISBI's investment consultant, as well as samples from eight investment consultant firms. Mr. Rivera stated that the likelihood of achieving the 7% investment return using the Meketa capital market assumption was 58%, adding that the same likelihood is closer to 50% using the capital market assumptions of the eight independent consulting firms.

Trustee Allison asked about the prudence of 2016 adoption of the 7% annual investment return assumption. Mr. Rivera answered that 7% was the average expected annual return of the eight consulting firms based on ISBI's asset allocation and a 20 year investment horizon. He added that if the plan were better funded, a less conservative approach could be taken by assuming a 7.25% annual investment return. But, due to the statutory funding plan and the low funded ratio, he recommended the assumption remain at 7%.

Trustee Allison asked if there was any sense of whether ISBI was changing its investment decisions as a result of the SERS Board's change in investment assumption. Mr. Rivera

stated that he believed ISBI would be looking at how best to manage risk and liquidity on a much shorter horizon and Secretary Blair added that at the meeting of ISBI on June 30, Me-keta had focused on achieving the 7% investment return while lowering volatility and still having assets to invest as opportunities arise.

Chairperson Mendoza asked if there were any further questions regarding Mr. Rivera's report. There being none, she asked for a motion to adopt the Economic Assumption Update Review for the June 30, 2017 Actuarial Valuation. Trustee Hawk moved to adopt the review. The motion was seconded by Trustee Latoza and passed unanimously. A copy of this review is made part of these minutes as *Exhibit B*.

Actuarial Recertification of FY 2018 State Contribution. Mr. Rivera referred the board to a document reviewing the impact of Public Act 100-0023 on the FY 2018 certified State contribution. The Act requires SERS to "smooth" the effect of assumption changes over 5 years and to recertify the FY 2018 State contribution, taking into account all assumption changes since FY 2014.

Mr. Rivera reviewed the assumption changes since FY 2014 and concluded the FY 2018 State contribution rate would be reduced from 54.013% of expected payroll to 47.342% of expected payroll. This amounts to a nearly \$300 million reduction in the State contribution when compared to the original FY 2018 certified contribution amount of almost \$2,030 billion.

Chairperson Mendoza asked if there were any questions. There being none, she asked for a motion to adopt the adjusted recertification. Trustee Hawk moved to adopt the FY 2018 State recertification amount as presented. The motion was seconded by Trustee Latoza and passed unanimously.

#### REPORT OF CHAIRPERSON MENDOZA

Chairperson Mendoza started her report by reminding the Board that the General Assembly passed a budget on July 6<sup>th</sup>. She stated that the budget includes increases in the individual and corporate income tax rates and authorizes the ability to borrow and issue bonds. She added that additional revenue from the tax increase would take at least several months to fully realize.

Chairperson Mendoza continued by stating that her office would work to aggressively pay off the bill backlog while also keeping pension payments a priority. She noted that S&P, Fitch and Moody's had all released statements that they would not be downgrading the State's credit status to junk as a result of the budget deal. She added that her office would continue to prioritize payments to human service providers, debt service payments and payments to the State pension systems while meeting employee payroll and General State Aid payments for schools.

Chairperson Mendoza stated that the Comptroller's Office would continue to operate as it has been until revenues start coming in and the Governor goes to market with a potential bond deal. She added that until a bond deal is reached, they would not be able to address the bill backlog or the \$800 million in annual late payment interest. Vice-Chairperson Morris asked how much gets added to the late payment interest amount per month and Chairperson Mendoza answered that roughly \$2 million per day is added.

Chairperson Mendoza continued her report by saying that her office is working with Senator Manar and Representative Crespo on HB 3649, which passed with bipartisan support. This legislation would require state agencies to report to the Comptroller's Office on a monthly basis the amount of their actual accrued debt as well as their best estimate for late payment penalties. Chairperson Mendoza added that the legislation would allow her office to better manage the state's budget crisis as well as providing legislators with better information to use when deciding how to move forward with a budget or borrowing needs. She stated that if signed, HB 3649 would take effect January 1, 2018.

Vice Chairperson Morris asked if the Comptroller's Office would have a better idea of how much state agencies were owed through June 30, 2017 after their reporting next month. Chairperson Mendoza stated that agencies are allowed until October to report all of their debt. She added that the information is out of date by this time and reiterated the importance of HB 3649 becoming law.

Trustee Hawk asked if there would be an improvement in payment of vouchers. Chairperson Mendoza answered that once they were able to go to the bond market and get bonding authority, she would approach paying back the bill backlog by leveraging for federal matching dollars and working to reduce the late payment interest penalty. She added that her office would continue to pay social service providers that do not receive late payment interest penalties through hardship requests. Trustee Hawk asked what the status of the back pay for state employees. Chairperson Mendoza answered that the status had not changed because it was not appropriated as part of the budget package.

Chairperson Mendoza concluded her report by asking if there were any additional questions. No further questions were offered.

#### REPORT OF ANY TRUSTEE

Chairperson Mendoza asked if any trustee would like to offer a report. No trustee offered a report.

#### REPORT OF AUDIT & COMPLIANCE COMMITTEE

Chief Internal Auditor Casey Evans began the Audit and Compliance Committee report by stating that the committee met at 9:00 am., adding that they approved the minutes of the April 25<sup>th</sup> meeting. He stated the committee completed the annual review of the internal audit charter and the review of the two-year audit plan as required by statute, with the committee approving the charter and audit plan.

Mr. Evans stated that they have FY 2018 planned audits to continue to recalculate retirement benefits for retirement annuities, survivor annuities and disability benefits on a monthly basis. He stated that they have planned work for the ongoing IT development of the SERS benefit setup module, adding that they had requested additional features and provided input on internal controls after working with the JRS/GARS system development. Mr. Evans stated that they also plan to audit the QILDRO process.

Mr. Evans stated that they have had two substantial audits, one covering survivor and death benefits and one covering cash receipts and receivables. He added that there had been one finding in each audit, both of which pointed to current system limitations and the need to continue to the current modernization efforts.

Mr. Evans concluded his report by stating that the next scheduled meeting of the Audit and Compliance Committee would be October 31st at 9 a.m. and offered to answer any questions from the Board. No questions were offered.

#### REPORT OF RULES AND PERSONNEL COMMITTEE

Trustee Latoza reported the Rules and Personnel Committee had met on Monday, July 24<sup>th</sup>, 2017, at 2 p.m. in the System's Springfield Office. He noted that present were Trustees Silverthorn, Latoza, and Hawk. Also present were Executive Secretary Tim Blair and Jeff Houch, Assistant to the Executive Secretary. He then turned the report over to Mr. Houch.

Mr. Houch stated that HB 2496 was awaiting the Governor's signature. He reminded the Board that this legislation deals with modernizing procedures within the disability division, specifically removing certain filing deadlines and signature requirements. He added that if the bill becomes law, the committee has authorized staff to pursue rulemaking to adjust the SERS sections of the Administrative Code.

Mr. Houch offered to answer questions. None were offered.

#### REPORT ON IT MODERNIZATION

Systems Modernization. Executive Secretary Blair reminded the Board that Gerry Mitchell retired at the end of June and that Kevin Rademacher would be providing the CISO report in the future.

Secretary Blair stated that the project charter for the IT modernization had been updated due to legislative changes made to the plan over the last few years, specifically the creation of Tier 2, preparing for the implementation of the Senate Bill 1 "consideration" model, as well as the Morneau Shepell health insurance deduction and coverage problems. In addition, he noted there were performance issues with the JRS/GRS benefit setup module, but added that he didn't expect the same performance issues with the SERS benefit setup module. Secretary Blair stated that there is a three-year time expectation for the project to be completed.

Secretary Blair continued by saying that work on the benefit setup module continues with efforts focusing on tying separate legacy systems together. He added that several groups are working on the various modules to stay on track with the new timeline and noted the SERS website now has over 50,000 registered members.

Chairperson Mendoza asked if there were any further questions regarding the report. None were offered.

#### REPORT OF ACCOUNTING DIVISION MANAGER

Alan Fowler, Accounting Division Manager, began his review of the March 31, 2017, financial statements by noting that when compared to the previous quarter, there was a \$40 million increase in withdrawals from the ISBI investment portfolio in order to meet the disbursements for the quarter ending 03/31/2017. He also noted the difference in the timing of the GRF contributions between the fiscal quarters compared, causing variances in the receipt of employer contribution from employing state agencies.

Mr. Fowler thanked the Comptroller's Office staff and mentioned that the GRF employer contribution payments were being released timely, so that only a half month's share of FY 2018 payments vouchered were awaiting release. Mr. Fowler noted that the FY 2017 GRF employer contribution appropriation had been fully paid out and that the annual reconciliation with the Comptroller's Office would take place after the lapse period has concluded.

Mr. Fowler concluded his report by offering to answer any questions. None were offered. Chairperson Mendoza asked for a motion to adopt the report. Vice-Chairperson Morris moved to adopt the FY 2017 third quarter financial statements. The motion was seconded by Trustee Silverthorn and it passed unanimously.

## REPORT OF THE EXECUTIVE SECRETARY

Final Review of FY 18 Operations Budget Request. Executive Secretary Blair began his report by stating that the final budget request had been reduced from the April request by roughly \$114,000, noting the reduction was in large part due to the recertification of SERS employer contributions rate approved earlier in the meeting. Secretary Blair added that the budget request funds all staff and group insurance for new call center staff starting September 1<sup>st</sup> as well as an attorney with a projected hire date of October 1<sup>st</sup>.

Secretary Blair concluding his review of the FY 18 budget request by offering to answer any questions. Trustee Allison asked for clarification on the removal of the actuarial audit. Secretary Blair stated that the State Actuary continues to recommend SERS complete a full scope actuarial audit. However, with annual review by the State Actuary and annual parallel valuations completed by the Commission on Government Forecasting and Accountability (COGFA), he considers the expense to be unwarranted. Trustee Allison asked if there was a statutory obligation to complete the audit and Secretary Blair replied that SERS has no statutory obligation and his suggestion would be to respond to the State Actuary's recommendation with the reasoning mentioned

Trustee Allison then asked who currently does the work of the proposed call center staff. Secretary Blair stated that those staff whose subject matter the call is about generally take those inquiries. Trustee Allison asked if there would be any savings with bringing on new staff. Secretary Blair answered that there are vacancies that haven't been filled in anticipation of the call center opening and that more reductions would occur through attrition.

Hearing no further questions, Chairperson Mendoza asked for a motion to adopt the FY 2018 budget request. Trustee Latoza moved to adopt the FY 2018 Final Operations Budget Request. The motion was seconded by Trustee Friedman and passed unanimously.

Legislative Update. Jeff Houch, Assistant to the Executive Secretary, began his report by mentioning recent legislation that has passed into law. He noted Public Act 100-0023 creates an alternate "hybrid" plan for current Tier 2 employees, consisting of a defined benefit component and a defined contribution component. He added that only those SERS members who are not coordinated with Social Security are eligible for the plan.

Mr. Houch stated that the separate retirement systems would work together on a trailer bill to address issues with the current bill. He noted that the legislation states the Board of Trustees of SERS would determine by resolution the implementation of the hybrid plan as soon as possible, adding that the bill sponsors would expect a resolution within the next few

months. Mr. Houch further added that the election process for those wishing to participate in the hybrid plan would be determined by the System.

Mr. Houch outlined several aspects of defined benefit component of the plan, stating that the benefit multiplier for the defined benefit portion is 1.25% of salary for each year of service and an employee contribution of 6.2% unless that amount exceeds the total normal cost, in which case the member would contribute the total normal cost. He added that the vesting requirement remains ten years and the normal retirement age must be no earlier than age 67.

Mr. Houch continued that the automatic annual increase would begin on the first anniversary of the annuity start date and would equal  $\frac{1}{2}$  the Consumer Price Index – W as opposed to the current increase of Consumer Price Index – U. He added that some of the changes that the systems would request would be consistency between the growth rates as well as the date of the automatic increase. Mr. Houch stated that the average final compensation period would be the average of the last ten years of salary, survivor benefits would be 66.7% of the annuity and would include the current qualifying conditions.

Mr. Houch highlighted the defined contribution component of the plan, which would consist of employee contributions, employer contributions and investment earnings. He added that employees would contribute 4% while the employer contribution rate can vary as determined by the employer as long as it is between 2% and 6%. Mr. Houch stated that it was important to mention that no member can be enrolled into the defined contribution component of the hybrid plan until it has attained qualified plan status from the IRS.

Trustee Allison asked if the variable employer contribution would be subject to negotiations with AFSCME or other unions. Mr. Houch stated that it was not subject to but could likely be included in future agreements.

Trustee Dawson asked about the constitutionality of the revision to the pension system. Comptroller Mendoza stated that it was constitutional because employees are given a choice of whether to participate in the plan. Secretary Blair added that the hybrid plan would be the default option for new hires but that they would have 30 days to choose between the new hybrid and the current Tier 2 plan. Mr. Houch added that the retirement systems would potentially request to increase the 30-day window to six months.

Trustee Allison asked how the new hybrid plan would save the state money. Mr. Houch replied that it would be difficult to project any savings until elections start. He stated that since it is such a small portion of the SERS member population, the impact would likely not be large and could potentially end up costing more. Trustee Tilden asked what the size of the population affected was. Mr. Houch answered less than 5%. Secretary Blair stated that he would follow up with the actual number.

Funding Update. Secretary Blair stated that the System is current in the receipt of State contributions, with FY 2017 funding complete.

#### APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the April, May and June 2017 Executive Committee minutes for review. There being no changes to the minutes, Trustee Latoza moved to approve the minutes as presented. Trustee Hawk seconded the motion, which prevailed by the affirmative vote of all present.

OLD BUSINESS

Chairperson Mendoza asked if there was any old business to consider. There was none.

NEW BUSINESS

Chairperson Mendoza asked if there was any new business to consider. There was none.

ADJOURNMENT

There being no further business to be brought before the Board, Chairperson Mendoza called for a motion to adjourn. Trustee Silverthorn made the motion to adjourn, seconded by Trustee Latoza. All members voted aye and the meeting adjourned at 12:00 p.m. Chairperson Mendoza thanked the Trustees and reminded them the next meeting is scheduled for October 31, 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: \_\_\_\_\_