

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE ANNUAL MEETING OF THE BOARD OF TRUSTEES

October 19, 2010

The annual meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, October 19, 2010, at 10:00 A.M. in the System's Springfield office located at 2101 South Veterans Parkway with videoconference location at the Bilandic Building, Room N700, and 100 West Randolph Street, Chicago, Illinois.

The following trustees were in attendance:

Daniel W. Hynes, Chairman
Lori Laidlaw, Vice Chairman
Thomas Allison
Renee Friedman
Joyce King
David Morris
Michael Noser
Patricia Ousley
Maria Pelaez-Peterson
Patricia Rensing
Harold Sullivan, Jr.
Virginia Yates

Absent was:

Danny Silverthorn

Others in attendance were:

Timothy Blair, Executive Secretary
Steve Bochenek, Attorney
Bill Atwood, Illinois State Board of Investment
Alex Rivera, Consulting Actuary
Paul Wood, Consulting Actuary
David Kausch, Consulting Actuary
Lawrence Stone, Internal Auditor
Gerald Mitchell, Chief Information Systems Officer
Barb Baird, Manager, Chicago Office
Nicholas Merrill, Manager, Accounting Division
Steve Zahn, Illinois State Board of Investment
Brian Wrubel, Marquette and Associates
Tom Davis, Davis American
Loren Iglarsh, Office of the Comptroller
Alexis Sturm, Office of the Comptroller
Dawn Blakeman, Recording Secretary

Chairman Hynes presided, and called the meeting to order at 10:00 a.m. with a quorum present.

REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT

Bill Atwood, Executive Director of the Illinois State Board of Investment (ISBI) distributed draft copies of the Flash Report (Executive Summary) for the period ending September 30, 2010, and introduced Brian Wrubel of Marquette and Associates, investment consultant to ISBI, to the Board. Mr. Atwood began by calling attention to the portion of the report reflecting a preliminary 7.8% gross return for fiscal year 2011 to date (FYTD), compared to the benchmark return of 8.1%. Mr. Atwood then reviewed the performance of various asset classes and pointed out that the U.S. equities have returned 10.0% FYTD, compared to the benchmark (Russell 3000) return of 11.5% while international equities have returned 15.7% FYTD, compared to the benchmark return of 16.5%. Mr. Atwood concluded his review by pointing out that real estate returns have been unsatisfactory, and private equity has returned 14.7% (net of fees) since inception, as of March 31, 2010.

Mr. Atwood then discussed a report prepared by ISBI at the request of the SERS board of Trustees. The report provided the returns earned by the portfolio and all current managers, net of fees, for the period ended June 30, 2010. Mr. Atwood then briefly discussed the selection and retention of managers and introduced Brian Wrubel, of Marquette and Associates. Mr. Wrubel began by mentioning the volatility in the financial markets has continued due to uncertainty about the economy. He briefly reviewed some of the asset classes that had been most affected by the economy, including real estate and fixed income investments.

Mr. Wrubel continued by explaining that he expected the extreme volatility to continue and pointed out that the Board's asset allocation should help offset some of the wild swings in individual assets classes. Mr. Atwood then added there are three asset classes the Board is paying particular attention to the mortgage-backed portfolio of ULLICO, the Amalgamated Bank portfolio and the large-cap growth manager Buford Dixon (BDHS), which is an emerging manager. Mr. Atwood explained that he and Senator Clayborne had recently met with representatives of Buford Dixon and they will continue to monitor the manager's performance closely.

After further explaining the poor performance in the fixed income portfolio, Mr. Wrubel and Mr. Atwood predicted things would improve in that sector. Mr. Atwood offered to answer any questions the Trustees may have. Mr. Atwood and Mr. Wrubel answered several questions regarding the fixed income portfolio and asset allocation. Chairman Hynes thanked Mr. Atwood and Mr. Wrubel for the report, and asked them to stay for the actuarial portion of the meeting.

Trustee Morriss moved to accept the Flash Report of the Illinois State Board of Investment for the period ending September 30, 2010. Trustee Ousley seconded the motion, which passed unanimously. A copy of this report is maintained in the office of the Illinois State Board of Investment.

REPORT OF THE ACTUARY

Chairman Hynes outlined several issues affecting the long-term funding issues of SERS and introduced Alex Rivera, Paul Wood and David Kausch of Gabriel, Roeder, Smith & Company to discuss the FY 2010 actuarial valuation and the related issues of the investment return assumption and the effect of reduced FY 2011 State contribution.

Mr. Rivera referred the trustees to a handout summarizing the results of the FY 2010 actuarial valuation. Mr. Kausch continued the presentation by stating the SERS accrued liabilities have increased to \$26.7 billion at June 30, 2010 from \$25.3 billion at June 30, 2009. Mr. Kausch pointed out that the lower benefit provisions created for new members beginning January 1, 2011 did not affect the liability growth in FY 2010, but pointed out that the lower benefits will reduce the rate of growth in liabilities significantly in future years.

Mr. Kausch then pointed out that SERS assets at market value had grown from \$8.6 billion at June 30, 2009 to \$9.2 billion at June 30, 2010. Based on the market value of assets, the unfunded liability grew from \$16.7 billion in FY 2009 to \$17.5 billion at the end of FY 2010. Over the same time period the funded ratio increased marginally from 33.86% to 34.46%.

Mr. Kausch reviewed the use of asset smoothing in determining the value of SERS assets and the calculation of the required employer contributions. He pointed out that for the purpose of determining the FY 12 employer contribution; the actuaries are still statutorily required to ignore \$1.8 billion in investments losses from FY 2009. These losses will be recognized over the next three fiscal years. Based on the actuarial value of assets, the funded ratio of SERS dropped from 43.48% in FY 2009 to 41.05% in FY 2010.

Several trustees then inquired about the status of the FY 2011 employer contribution to SERS. Secretary Blair explained the law allows the entire FY 2011 contribution to be made as certified by the Board in November 2009, but the vouchers that have been submitted pursuant to statute have not been paid due to a lack of State revenues. Chairman Hynes pointed out that non General Revenue Fund (GRF) State contributions have been made, but that no contributions representing GRF have been remitted to SERS. Secretary Blair pointed out that only about one third of the contributions come from non-GRF sources. Mr. Kausch next briefly reviewed the reasons for the change in the funded ratio during FY 2010 and provided a comparison of cash flows for FY 2010 and the projected cash flows for FY 2011.

Mr. Kausch then provided the trustees with the State contribution required for FY 2012, which totaled \$1.333 billion, or 31.42% of expected payroll. This was an increase from the FY 2011 certified contribution of \$1.269 billion, or 30.25% of payroll. In response to a question from Trustee Allison, Mr. Kausch and Mr. Rivera briefly reviewed the reasons for the increase in the contribution rate and explained how the System collects debt service to remit to the State to pay the debt service on the 2003 pension obligation bonds.

Mr. Kausch then reviewed the adequacy of the employer contribution rate when compared to the annual required contribution as defined by the Governmental Accounting Standards Board and the effect of the Tier 2 legislation on the FY 2012 contribution rate. Based on related questions from the Trustees, Mr. Rivera pointed out that some of the components of the funding plan are based in actuarial principles, but there are components the defer contributions and tend to "back-load" the funding plan.

Mr. Kausch and Mr. Rivera explained the supporting appendices and answered various complex funding and actuarial questions posed by the trustees.

Mr. Rivera then presented to the trustees a review of the funding policy. The areas to be reviewed that include the effect of the lower benefit tier (Public Act 96-889) on the system, the implications of reducing the FY 2011 contribution, the reasonableness and impact of changing the investment return assumption and possible ways to strengthen the funding policy.

PUBLIC ACT 96-0889

Mr. Rivera pointed out that P.A.96-0889 reduced the FY 2012 contributions to SERS, even though the reduction in the liability (and reduced cash outlays) will not accrue to the retirement system for several years. In effect, this tends to defer State contributions and weaken the funded status of SERS.

LOWERING THE FY 2011 CONTRIBUTION RATE

Reducing the FY 2011 contribution amount to reflect only non-GRF employer contributions results in increased contributions for the remainder of the funding plan. Mr. Rivera estimates the increase in the contribution rate for years after FY 2011 to be 1.23% of payroll annually.

ASSESSING THE INVESTMENT RETURN ASSUMPTION

Based on financial condition of the system, Mr. Rivera had been asked to assess the reasonableness of the 8.5% investment return assumption. To do so, he completed a Monte Carlo simulation based on ISBI’s target asset allocation and a sample of capital market assumptions provided by eight different investment consulting firms. The simulation provided that the current portfolio has a 36% chance of earning a cumulative annual return of 8.5% net of expenses, over the next 20 years. Mr. Rivera stated a more conservative assumption would produce results of 45% to 50%.

IMPLICATIONS OF LOWERING THE INVESTMENT RETURN ASSUMPTION

Mr. Rivera presented the results of lowering the investment return assumption to 7.5%. Lowering the rate increases the FY 2012 base contribution rate from 29.5% to 33.2% and decreases the June 30, 2010, funded ratio from 39.5% to 34.6%. But, the funding policy would be strengthened and SERS would receive more contributions in the near term.

The trustees discussed the presentation and Mr. Rivera answered several related questions posed by the Board. Chairman Hynes outlined the discussion and asked the trustees for opinions on any action that should be taken by the Board. Several trustees, along with Mr. Atwood and Mr. Wrubel, offered opinions and Trustee Laidlaw made a motion to reduce the investment return assumption to 8.0%. Trustee Allison seconded the motion and a roll call was taken as follows:

Trustee Allison	Yes	Trustee Peterson	No
Trustee Friedman	No	Trustee Rensing	Yes
Trustee King	Yes	Trustee Sullivan	No
Trustee Morris	No	Trustee Yates	Yes
Trustee Noser	No	Vice-Chairperson Laidlaw	Yes
Trustee Ousley	No	Chairman Hynes	Present

Statutorily, seven affirmative votes are required for any Board action to pass. With a final vote of six trustees voting yes, five trustees voting no and one trustee voting present, Chairman Hynes announced the motion had failed.

After further discussion among the trustees and actuaries, a motion was then put forward by Trustee Sullivan to reduce the investment return assumption to 7.75% and to review the assumption in one year. The motion was seconded by Trustee Morris and all trustees in attendance voted in the affirmative.

After some discussion, the Board agreed to convene a special Board meeting on November 10, 2010, at 10 a.m. in order to allow the actuaries time to prepare the June 30, 2010 actuarial valuation based on the change in the investment return assumption to 7.75%. At that meeting, the Board will certify the FY 2012 contribution amount based on the lower assumption and submit the certification prior to the November 15, 2010 statutory deadline.

MINUTES OF JULY 27, 2010 BOARD MEETING

The minutes of the meeting of the Board of Trustees held July 20, 2010, were presented to the members by Chairman Hynes for approval. Copies of these minutes were previously mailed to each trustee for preliminary review.

There being two minor corrections, Trustee Ousley moved to approve the minutes as corrected. Trustee Rensing seconded the motion, and all were in favor.

REPORT OF THE CHAIRMAN

Election of 2011 Officers Chairman Hynes informed the Board members the election of Vice-Chairperson for 2011 was in order and opened the floor for nominations. Chairman Hynes then nominated Lori Laidlaw for election to the position. The motion was seconded by Trustee King. There being no further nominations, Chairman Hynes closed the nominations. The vote which followed resulted in the unanimous election of Lori Laidlaw to the office of Vice-Chairperson for calendar year 2011.

Appointment of Executive Committee Chairman Hynes announced the annual appointments to the Executive Committee were in order. Thereupon, he moved to reappoint Loren Iglarsh as the Committee's Chairman, with Vice-Chairperson Laidlaw and Executive Secretary Blair as Committee members. The motion was seconded by Trustee Rensing and all trustees in attendance voted in the affirmative. The Chairman expressed his appreciation to the members for their time and effort serving on the Committee.

REPORT OF INTERNAL AUDITOR

The System's Internal Auditor, Larry Stone, addressed the Board, and summarized his accomplishments since his last report to the Board. Mr. Stone performed an audit of the system's controls regarding the identification of reciprocal retirees who have returned to work. The audit found that these processes needed improvement and recommended meeting with the other larger reciprocal systems to discuss these findings and to improve the reporting process used in the current Data Exchange.

The death match for this period identified \$35,131.39 in overpayments that were avoided in September. The Claims Division recently took over the duties of completion of the death match. The death matches were completed for July and August, but the results for those months were not tracked.

Vice-Chairperson Laidlaw moved acceptance of the Internal Auditor's report for this period. Trustee Ousley seconded the motion, all were in favor.

FOURTH QUARTER FINANCIAL REPORT

Nicholas Merrill, Manager of the Accounting Division, presented the financial report for the fourth quarter of Fiscal Year 2010.

Mr. Merrill indicated that for FY 2010, the System had received the vast majority of the employer contributions due to the remittance of bond proceeds to SERS in January 2010. In addition, the System has submitted a voucher, in accordance with statute, that requires the State to make another small FY 2010 contribution due to a minor shortfall in employer contributions from the proceeds of the bond sale.

Following the discussion, Trustee Yates moved to accept the financial report for the fourth quarter. The motion was seconded by Trustee Morris, and passed unanimously. A copy of this report is on file.

REPORT OF EXECUTIVE SECRETARY

Fiduciary Liability Insurance Secretary Blair introduced Tom Davis of Davis-American, Ltd. to provide an update to the trustees on the search for fiduciary liability insurance. Mr. Davis thanked the trustees for the Board attention and distributed information to the Board. Mr. Davis notified the Board that the insurance application had been provided to eleven insurance carriers. Only four of these eleven carriers have elected to submit a proposal to the Board, primarily based on the serious funding issues facing the system.

Mr. Davis pointed out the main purpose of the fiduciary liability insurance is to provide the trustees with coverage for the cost of defense. He then briefly explained the duties of a fiduciary and some of the issues involved with choosing a carrier. The trustees asked several questions regarding the health of vari-

ous fiduciary liability insurance carriers and Mr. Davis provided informative answers. Mr. Davis then wrapped up his presentation and informed the trustees that he would have a proposal for their consideration at the January Board meeting.

Calendar Year 2011 Meeting Dates In order to abide by the Open Meetings Act, it is necessary to post a schedule of meetings for the ensuing year in the System's offices and on the web site, as well as publish the schedule in a State newspaper.

The following meeting dates and time were agreed upon for calendar year 2011:

Thursday, January 20

Tuesday, April 19

Tuesday, July 19

Tuesday, October 25

All 2011 meetings will be held in the Springfield office with the video conference option in Chicago.

IT Update Gerry Mitchell, CISO of the System, provided a brief update of the SRS Modernization Project. Recent accomplishments include the development of a new Human Resource System to be implemented December 1, 2010. The Division also continues to make modifications in the line of business systems in order to implement the Tier 2 benefit structure.

The Division continues to move forward on modernization of all systems and will begin modernization of the Accounting Division and the Active Member System. In addition, the Division has selected a consultant to begin to research the agency's needs in regards to an imaging system.

Trustee Sullivan requested that Mr. Mitchell provide the Board with an analysis of the benefits of every project undertaken by the Division in the future. Mr. Mitchell agreed that it is important that the Board understand the benefits of all modernization projects as the modernization progresses more rapidly.

Funding Issues Secretary Blair outlined the current status of the FY 2011 employer contribution. He explained that current statute allows the System to send vouchers to the Comptroller's Office on a monthly basis for the amount of the FY 2011 employer contribution. Unfortunately, the dire financial condition of the State will preclude the contributions from actually coming into the System in a timely manner. The System has prepared cashflow projections for FY 2011 which assume that no monthly employer contributions will be made to SERS.

Secretary Blair explained that if the State is able to borrow the money through the issuance of General Obligation Bonds, the entire FY 2011 employer contribution could then be made to the System. Several Trustees voiced concern over the uncertain status of the FY 2011 employer contribution and directed the System's attorney to research possible alternatives the Board may pursue to ensure receipt of the FY 2011 employer contribution.

At the July Board meeting, trustees requested Steve Bochenek, attorney for SERS, to review the Board's legal options in compelling the State of Illinois to fund the System. Mr. Bochenek reviewed the 1995 Skłodowski case and presented his findings to the Board. In summary, in the Skłodowski decision, the Illinois Supreme Court has determined that the level of funding of the System does not impose a fiduciary duty upon the trustees to pursue litigation to increase the funding level unless the trustees have a reasonable belief based upon the facts and information available to the trustees that the system is "on the verge of default or imminent bankruptcy."

EXECUTIVE COMMITTEE MEETING MINUTES

The trustees had previously been furnished with copies of the July, August and September 2010, Executive Committee minutes for review. Following a short discussion, Trustee Noser moved for the adoption of the minutes. Trustee King seconded the motion, which prevailed by the affirmative vote of all trustees.

OLD BUSINESS

There was no old business to be discussed.

NEW BUSINESS

Closed Session for Personnel Matters Vice-Chairperson Laidlaw made a motion to go into closed session to consider the appointment, employment, compensation, discipline, performance or dismissal of specific employees of the State Employees' Retirement System. The motion was seconded by Trustee Rensing and all trustees in attendance voted in the affirmative.

Trustee Rensing made a motion to return to open session. The motion was seconded by Trustee Ousley and all trustees in attendance voted in the affirmative. The Board returned to open session. Trustee Rensing moved to appointed Kathy Yemm to a 4 year term as the Claims Division Manager, effective November 1, 2010 and Dave Thompson to a 4 year term as the Field Services Division Manager, effective December 1, 2010. Trustee Ousley seconded the motion and all trustees where in favor.

Board Resolution for Chairman Hynes Vice-Chairperson Laidlaw presented Chairman Hynes with a Resolution of appreciation thanking him for his service to the SERS Board of Trustees. Vice-Chairperson Laidlaw and Executive Secretary Blair thanked Hynes for the leadership he had provided to the Board during very difficult times. All trustees present then thanked Chairman Hynes for his dedicated service to the Board. Vice-Chairperson Laidlaw moved to adopt the resolution. Trustee Morris seconded the motion and all trustees were in favor.

ADJOURNMENT

There being no further business to be brought before the Board, Trustee Ousley moved for adjournment at **1:15 P.M.** seconded by Trustee Rensing.

Judy Baar Topinka, Chairman

Date: _____

ATTEST:

Timothy Blair, Executive Secretary

Date: _____