

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE REGULAR MEETING

OF THE BOARD OF TRUSTEES

October 25, 2011

The annual meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, October 25, 2011, 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 14-612, 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
Harold Sullivan, Jr., Trustee
Virginia Yates, Trustee

Absent:

Danny Silverthorn, Trustee

Others in attendance were:

Timothy Blair, Executive Secretary
Steve Bochenek, Attorney
William Atwood, Director, Illinois State Board of Investment
Nicholas Merrill, Manager, Accounting Division
Lawrence Stone, Internal Auditor
Alex Rivera, Gabriel Roeder Smith & Company
Paul Wood, Gabriel Roeder Smith & Company
Loren Iglarsh, Office of the Comptroller
Alexis Sturm, Office of the Comptroller
Barbara Baird, SERS Chicago Office
Dawn Blakeman, Recording Secretary

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

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REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT

William Atwood, Director of the Illinois State Board of Investment (ISBI) distributed draft copies of the Flash Report (Executive Summary) for the period ending September 30, 2011, and addressed the Board. He called attention to the portion of the report reflecting a -9.0% return for the first three months of FY 12 and a -3.5% return for the calendar year to date. The FY 12 total portfolio benchmark totaled -9.2% while the calendar year to date benchmark was -5.3%. Director Atwood pointed out the portfolio outperformed the benchmark, and noted the recent extreme volatility in the financial markets. He also reminded the Board the portfolio returned 21.7% in FY 11 and pointed out that until recently the current recovery had been the only one in history that had not had a 10% correction in the stock market.

Director Atwood reviewed for the Board various actions taken at the September ISBI meeting. Based on an asset allocation study performed by ISBI consultant Marquette and Associates and adopted by the ISBI Board at the June meeting, ISBI allocated \$145 million to an emerging market index fund, \$200 million to a small cap index fund and \$150 million to core real estate. At the December ISBI meeting, Mr. Atwood expects the Board to allocate approximately \$450 million to mid cap growth equities and \$320 million to a global bond allocation.

Director Atwood then explained to the Trustees that the ISBI Board, like all investors, is very concerned with “macro” factors, most specifically the European debt situation and the Congressional super-committee. He believes the Europeans are now more committed to solving their debt issues even though there are still significant European Union governance problems. The Congressional super-committee is approaching a deadline but there doesn’t seem to be the political will to do what needs to be done. If the super-committee does nothing there remains a possibility of an additional downgrade of U.S. debt.

On a positive note, Director Atwood pointed to the health of the balance sheets of U.S. corporations. In fact, current U.S. balance sheets are stronger than they have ever been, with low debt and high cash balances. Still, there seems to be a hesitancy to invest due to the lack of confidence in the direction of the global economy. Director Atwood then informed the Board that he would have a net of fees report to them by the end of the week and offered to address any questions the Board may have.

Trustee Noser mentioned that he had heard that we can expect to realize smaller returns going forward and asked Director Atwood’s opinion on the subject. Director Atwood explained that over any time horizon he expects investors to continue to receive compensation for holding equities and debt, but the rate of compensation may be lower due to lower current inflation.

Trustee Allison followed up by requesting that the next time the investment return assumption was reviewed the long-term return expectation of the System’s portfolio should be provided to the Board. Mr. Atwood agreed that the analysis could be provided by Marquette and Associates and further explained that Marquette regularly reviews the asset allocation model and projects the expected returns for a 5 year time horizon.

Trustee Noser then noted that he was unable to locate the minutes of ISBI's meetings on the Board's website. Director Atwood stated the minutes are not posted to the website until they are approved by the Board.

Comptroller Topinka then asked Director Atwood about any possible involvement with a Dr. Smith, who is under indictment for several types of illegal activity involving State grants. Director Atwood promised to review the issue and let the Board know what he found. Trustee Sullivan then followed up by asking Director Atwood if he was aware of the Board doing any business with anyone under indictment. He answered that the Board would immediately terminate any relationship with anyone under indictment and pointed out the Board is rigorously audited every year. Trustee Morris, an employee of the Department of Children and Family Services, added that the indictment of Dr. Smith involved the Illinois State Board of Education (ISBE), rather than ISBI.

Trustee Noser moved to accept the ISBI Flash Report for the period ending September 30, 2011 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 and the Trustees thanked Director Atwood for his informative report and excused him from the remainder of the meeting.

REPORT OF THE ACTUARY

June 30, 2011 Actuarial Valuation. Alex Rivera and Paul Wood of Gabriel, Roeder, Smith & Company presented the FY 2011 actuarial valuation, including the calculated FY 2013 certified employer contribution.

Mr. Rivera referred the trustees to a handout summarizing the results of the FY 11 actuarial valuation. He pointed out two changes that impacted the FY 11 valuation; the change in actuarial assumptions and using "capped" Tier 2 payroll in calculating the FY 13 certified State contribution. Mr. Rivera told the Trustees he would more fully explain these two changes and the impact on SERS later in the presentation. He continued by referring to the portion of the presentation that showed the increase in the funded ratio from 31.4% in FY 10 to approximately 35.0% in FY 11, based on the market value of assets.

Mr. Rivera continued the presentation by pointing out that net cash flow in FY 2011 was negative as the employer and employee contributions were \$162 million less the benefits and expenses. For FY 12, estimated employee contributions and required employer contributions are expected to be \$29 million higher than projected benefits and expenses. This positive cashflow will significantly help the financial condition of the System over time.

Mr. Rivera then reviewed the FY 2013 required contribution to be certified by the Board (36.116% of payroll) and compared it to the certified FY 2012 contribution (32.252% of payroll). Switching to "capped" Tier 2 payroll resulted in an increase in the contribution rate of approximately 1.7% of payroll (\$72 million) in FY 2013, while the assumption changes adopted by the Board increased the FY 2013 contribution by about 1.4% of payroll. Mr. Rivera further pointed out that the increase in the certified employer contribution still

did not comply with the “Annual Required Contribution” or ARC, outlined by the Governmental Accounting Standards Board (GASB).

Mr. Rivera explained the rationale for using “capped” Tier 2 compensation in the calculation of the FY 2013 employer contribution. The change allows the Board to certify an employer contribution rate that is based on the same compensation on which employee contributions are based. In addition, this approach removes some of the deferral of employer contributions that results from the passage of the Tier 2 benefit structure. This employer contribution deferral actually allows the financial condition of SERS to deteriorate further even though accrued liability is expected to grow at a reduced rate.

The Trustees then questioned and discussed the “capped” versus “uncapped” payroll issue with Mr. Rivera and how this approach affects the employer contribution and the possible usage of the ARC outlined by GASB. After further discussion of the statutory funding plan and the calculation of the required employer contribution, Trustee Sullivan asked Mr. Rivera why he was using a funding calculation approach he didn’t endorse. Mr. Rivera replied that he was required to use the statutory funding formula to calculate the required employer contribution whether he endorsed it or not. The only alternative is to change the statutory funding plan.

Comptroller Topinka then asked Mr. Rivera if we should try to change the funding statute, to which he responded that is a policy question that should be addressed by the Board. Trustee Sullivan asked about the usage of conservative assumptions and what Mr. Rivera would suggest are conservative assumptions. Mr. Rivera responded that a lower investment return assumption would be more conservative. Based on further discussions of funding methodology and assumptions, the Board directed Executive Secretary Blair to draft revised statutory funding language that reflects funding as recommended by GASB.

Trustee Morris moved to adopt the FY 2011 actuarial valuation as presented by GRS. Vice-Chairperson Laidlaw seconded the motion and a roll call vote was taken.

Allison	Yes	Rensing	Yes
Byrd	Yes	Sullivan	Yes
Friedman	Yes	Yates	Yes
Morris	Yes	Laidlaw	Yes
Ousley	Yes	Noser	abstain
Topinka	Yes		

Trustee Noser stated he did not have time to go through the detailed information contained in the valuation and the GRS presentation. The motion carried with ten affirmative votes and one abstention.

Certification of FY2013 Employer Contribution Rate. State contributions to SERS are required by the statutory formula established under Public Act 88-0593, as modified by Public Acts 93-0002, 93-0839, 94-0004 and 96-0043. The Board must by law certify the FY 2013 State contribution to the Governor and General Assembly by November 15 of each year.

Following discussion, Trustee Morris presented a motion to certify the FY 2013 State contribution rate of 37.987% of payroll, or \$1,659,576,000 in accordance with Public Act 88-0593, as modified by Public Acts 93-0002, 93-0839, 94-0004 and 96-0043. The motion was seconded by Vice-Chairperson Laidlaw. Trustee Friedman questioned Mr. Rivera regarding the process of calculating the required contribution and the effect of certification. Trustee Noser then clarified the use of “capped” Tier 2 compensation in the calculation of the required contribution.

Executive Secretary Blair pointed out the certified FY 13 contribution is approximately \$210 million higher than the Certified FY 12 contribution. The primary reasons for the increase are the revised actuarial assumptions adopted by the Trustees at the July 2011 Board meeting and the use of “capped” Tier 2 payroll for the first time in the FY 11 actuarial valuation. Mr. Rivera agreed and added that the only way he could foresee certifying a higher employer contribution would be to change the statutory funding plan, as the recent changes to more conservative assumptions has already increased the required employer contribution.

Trustees Friedman and Allison followed up by asking if the current 7.75% investment return assumption remains practical and accurate. Trustee Allison suggested polling other retirement systems about the usage of a more conservative investment return assumption to reflect sentiment in the financial markets. Trustee Friedman pointed out the 10 year return provided by ISBI is 4.7% annually. Secretary Blair pointed out that even with this low return, the 30 year annualized return provided by ISBI is closer to 9%.

Comptroller Topinka then called for Secretary Blair to clarify the motion and requested a roll call be taken of the vote.

Allison	Yes	Rensing	Yes
Byrd	Yes	Sullivan	No
Friedman	No	Yates	Yes
Morris	Yes	Laidlaw	Yes
Ousley	Yes	Noser	No
Topinka	Yes		

The motion to certify the FY 13 employer contribution passed by a vote of 8 to 3. Secretary Blair explained he could provide in the certification document the reason for the three negative votes is the current limitations placed on the Board and the actuaries by the statutory funding plan. After further discussion the Board agreed to submit the normal certification document.

MINUTES OF THE JULY 19, 2011 BOARD MEETING

The minutes of the meeting of the Board of Trustees held July 19, 2011 were presented to the members by Chairperson Topinka for approval. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Morris moved to approve the minutes as submitted. Trustee Ousley seconded the motion, and all were in favor.

REPORT OF CHAIRPERSON

Election of 2012 Vice-Chairperson. Chairperson Topinka informed the Board members the election of Vice-Chairperson for 2012 was in order and opened the floor for nominations. Trustee Rensing nominated Lori Laidlaw for election to the position. The motion was seconded by Trustee Yates. There being no further nominations, Chairperson Topinka closed the nominations. The vote which followed resulted in the unanimous election of Lori Laidlaw to the office of Vice-Chairperson for calendar year 2012.

Appointment of Executive Committee. Chairperson Topinka announced the annual appointments to the Executive Committee were in order. Thereupon, she 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 Nosser and all trustees in attendance voted in the affirmative. The Chairman expressed her appreciation to the members for their time and effort serving on the Committee.

REPORT OF THE INTERNAL AUDITOR

The System's Internal Auditor, Larry Stone, addressed the Board, and summarized his accomplishments since his last report to the Board.

Audits completed for this period. This examination included a review of the imaging development project. The audit reflects activity through the testing and evaluation of the Judges' Retirement System (JRS) and the General Assembly Retirement System (GARS) imaging system and an assessment of the State Employees' Retirement System (SERS) imaging system User Requirements. Implementation has begun in JRS and GARS with SERS tentative implementation in March 2012. There were no audit issues and the audit report was provided to Trustees.

Death Match. There were three monthly death matches completed since the last Board of Trustees meeting. The amount of potential overpayments detected was \$80,985.00.

Internal Audits. As required by the Fiscal Control & Internal Auditing Act, Mr. Stone conducted a peer review of State Universities Retirement System and Teachers' Retirement System of Illinois conducted a Peer Review of our Internal Auditing environment. State statute mandates a peer review be conducted every 5 years. The peer review found Mr. Stone generally conforms with the Act, with the exception of some performance standards that can be approved upon. According to the report provided to the Board and Secretary, Mr. Stone partially conforms on several other issues.

Vice-Chairperson Laidlaw and Comptroller Topinka asked Mr. Stone to review the findings. Mr. Stone briefly reviewed the peer review findings as they pertain to things he can do better. Vice-Chairperson Laidlaw expressed the opinion that audits are one of the most important functions of an Agency and she pointed out the job of the internal auditor is to protect the Trustees and to prevent fraud. Comptroller Topinka asked if the controls against fraud are adequate. Mr. Stone replied that he believes they are adequate.

Based on questions from Comptroller Topinka and Vice-Chairperson Laidlaw, Mr. Stone explained the death match process and the collection of overpayments. Trustee Allison followed up the discussion with comments on various media stories regarding non-public employees becoming members of a public retirement system, specifically the Chicago Laborers' Fund. Trustee Allison asked Mr. Stone if the Trustees have any reason to be concerned with this problem occurring at SERS. Mr. Stone answered in the negative and gave several examples of safeguards already in place. Trustee Allison then questioned whether there are members of SERS who are not State employees, specifically lobbyists for labor organizations.

Comptroller Topinka asked Secretary Blair to comment on lobbyists who may be participating in SERS. Secretary Blair informed the Trustees that legislation passed in 2007 created a 6-month window that allowed labor organization representatives and employees to elect to participate in SERS if they had previously been an SERS participant. He explained three people employed by the Illinois Federation of Teachers (IFT) had opted into SERS during the window period. The legislation required the employee and employer contributions to be made by the member or the IFT, at the same employee and employer contribution rates as other members and the State.

Secretary Blair further explained that one member who elected to participate purchased her prior service as a union employee and contributed more than \$480,000 in employee and employer contributions to SERS. This member has since retired and now receives a retirement of about \$8,000 per month. The other 2 IFT employees who opted into the Fund are currently active contributing members of SERS. The IFT is submitting payroll data and the required employee and employer contributions to SERS for these two members.

Based on questions from Trustee Allison, Secretary Blair noted the 2007 legislation prohibits these particular members from participating for this same service under any other Article of the Pension Code. Secretary Blair informed the Trustees of a Freedom of Information Act (FOIA) request from the Chicago Tribune. Among other things, the request included the names and affiliation of labor organization representatives or employees who are SERS members or retirees. The System will answer the request and provided the name of the IFT retiree (Gail Purkey) to the Trustees.

Trustee Allison again asked if the legislation requires the employee and employer contributions to be made to SERS. Secretary Blair assured the Trustees that all contributions are required to be made by the member and/or the organization and informed the Trustees the other 2 current IFT participants are John Little and Michelle Federici.

Based on additional questions from Trustee Sullivan, Secretary Blair informed the Board that the legislation was SB 36 (Public Act 94-1111) from the 94th General Assembly.

SERS Auditor Independence Statement. A copy of this statement was mailed to each Trustee for review. Secretary Blair has reviewed and approved the statement that there are no independence or objectivity impairments which would preclude Mr. Stone from conducting his responsibilities as the Chief Internal Auditor.

Mr. Stone offered to answer any questions the Board may have. Trustee Morris moved acceptance of the Internal Auditor's report for the period. Trustee Rensing seconded the motion, all were in favor.

REPORT OF THE EXECUTIVE SECRETARY

Calendar Year 2012 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. Vice-Chairperson Laidlaw made a motion, seconded by Trustee Yates, to approve the 2012 meeting dates. All Trustees voted in the affirmative for the following meeting dates for 2012:

Thursday, January 19
Tuesday, April 17
Tuesday, July 17
Tuesday, October 16

All 2012 meetings will be held at 10 a.m. in the System's Springfield office with the video conference option in Chicago.

IT Update on Modernization. Gerry Mitchell, CISO of SRS, was not able to attend the Board meeting. Executive Secretary Blair provided a brief overview of Mr. Mitchell's report by pointing out the System's modernization efforts.

Secretary Blair provided an update on the imaging project. Since the last board meeting, building changes are still in process to accommodate the imaging system. Secretary Blair informed the Board that the imaging of member records began for JRS and GARS on October 3rd. Of the approximately 300,000 JRS/GARS records to be imaged, roughly 10% have been completed.

Secretary Blair also updated the Board on the progress of the modernization of the active member database and the updating of SERS' disaster recovery plan, which he expects to be completely updated by June 30, 2012. He expects the initial modernization of the active member database to be completed in April 2012.

FY 2012 Funding Update. Secretary Blair informed the Trustees that SERS has received money from the State representing FY 12 employer contributions through mid-September. Comptroller Topinka added that her office is trying to provide some predictability to all of the State-funded systems by making at least partial employer contributions to all of the Systems. Secretary Blair added that the scheduled November withdrawal from the ISBI was cancelled due to the more timely employer contributions.

FOURTH QUARTER FINANCIAL STATEMENTS

Nicholas Merrill, Manager of the Accounting Division, presented the financial statements for the fourth quarter of Fiscal Year 2011.

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Mr. Merrill indicated that for FY 2011, 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.

Mr. Merrill also explained to the Trustees that there had been a statutory reduction in the FY 2011 certified rate, and therefore SERS refunded \$17 million to non-GRF funds, reflecting the mid-year decrease in the certified employer contribution rate. Overall, Mr. Merrill classified FY 11 a rather uneventful year.

Following his comments, Trustee Noser inquired about the total FY 11 ISBI withdrawals of \$857 million, as reported on Schedule 3 of the financial statements. Mr. Merrill pointed out that in addition to these withdrawals, SERS also transferred approximately \$689 million to ISBI, resulting in net withdrawals of less than \$175 million in FY 11. This transfer pattern has been used by SERS staff to keep cash balances relatively low and invested assets as high as possible during the year, when 70% of the employer contribution was made from bond proceeds, rather than submitted periodically.

On motion by Trustee Ousley, seconded by Vice-Chairperson Laidlaw, and by unanimous vote, the Board approved the financial statements as presented for the period April 1, 2011 through June 30, 2011. Copies of the financial reports are attached to these minutes as Exhibit C.

APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the July, August and September, 2011, Executive Committee minutes for review.

There being no changes to these minutes, except that the minutes pertaining to the appeal of Jill Gordon be held without action pending the deposition of a physician, Trustee Morris moved for their adoption. Vice-Chairperson Laidlaw seconded the motion, which prevailed by the affirmative vote of all trustees.

OLD BUSINESS

Comptroller Topinka inquired as to the number of employees who have SERS credit cards. Secretary Blair informed the Board that there is one agency credit card that is used by Dawn for miscellaneous Board-related expenses, primarily Board meetings and Executive Committee meetings. There was no old business brought before the Board.

NEW BUSINESS

Trustee Noser commented on the difficulty of reviewing complicated material that is handed out at the Board meeting, and requested the distribution of all meeting material as soon as possible. Secretary Blair explained the difficulty in compiling all information re-

quired for the October meeting, specifically the asset number that is provided by ISBI. Trustee Noser asked if we could move meeting dates to accommodate the Trustees. Secretary Blair offered to amend the calendar year 2012 meeting schedule. After further discussion, Trustee Noser moved to schedule the October 2012 meeting on the 30th, rather than the 16th, to allow the actuaries and board additional time to consider the annual employer certification. Trustee Friedman seconded the motion and it was passed with all Trustees voting in the affirmative

Trustee Allison suggested moving all of the meetings back a week or more to allow ISBI to provide the Board with net-of-fees investment return information. After further discussion it was decided that the dates of the other 2012 meetings would not change.

Trustee Sullivan suggested we “go green” and have all meeting materials sent electronically. Secretary Blair agreed with him and said he would do it for the January 2012 Board meeting.

Board and Employee Resolution. Secretary Blair presented a resolution for ex-board member Maria Pelaez-Peterson for approval to the Board, who resigned from the Board in July. This Resolution of appreciation thanks Ms. Peterson for her diligent service to SERS. Also, 2 resolutions were presented for approval for 2 retiring employees, Janie Taft and Vickie Haas with over 40 years of knowledge between them. Trustee Rensing moved to adopt the resolutions, Trustee Morris seconded the motion and all trustees were in favor.

ADJOURNMENT

There being no further business to be brought before the Board, Trustee Morris moved for adjournment at 12:40 P.M. The adjournment motion was seconded by Trustee Yates and all were in favor.

Judy Baar Topinka, Chairperson

Date: _____

ATTEST:

Timothy Blair, Executive Secretary

Date: _____

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