

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE ANNUAL MEETING
OF THE BOARD OF TRUSTEES

October 31, 2017

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, October 31, 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:

David Morris, Vice-Chairperson
Thomas Allison, Appointed Trustee
Yasmin Bates-Brown, Appointed Trustee
Shaun Dawson, Elected Active Trustee
Stephen Mittons, Elected Active Trustee
Danny Silverthorn, Appointed Trustee
John Tilden, Elected Retired Trustee

Absent:

Susana Mendoza, Chairperson
Renee Friedman, Appointed Trustee
Tad Hawk, Elected Active Trustee
Carl Jenkins, Appointed Trustee
Alan Latoza, Elected Retired Trustee

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
Kevin Rademacher, Manager, IT Division
Casey Evans, Chief Internal Auditor
Staceyann Cabey-Kaufmann, Internal Auditor
Jessica Blood, Recording Secretary
Vanessa Martin, Office Coordinator, SERS Chicago Office
Loren Iglarsh, SERS Retiree

Vice-Chairperson Morris called the meeting to order at 10:15 a.m. with a quorum present.

PUBLIC COMMENTS

Vice-Chairperson Morris 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 JULY 25, 2017 BOARD MEETING

The minutes of the Board meeting held on July 25, 2017 were presented to the members by Vice-Chairperson Morris. Copies of these minutes were previously provided to each trustee for review. Trustee Silverthorn moved to approve the minutes as submitted. Trustee Dawson 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 June 30, 2017. He began by reporting that in FY 2017, the total portfolio returned 12.3%, net of fees, slightly outperforming the benchmark return of 12.0%. Director Atwood added the portfolio totaled more than \$17.3 billion on June 30, 2017, and had increased to almost \$18 billion by October 23, 2017. He then reported the Fixed Income portfolio returned 0.9%, net of fees, in FY 2017, matching the benchmark return, while the Equity portfolio returned 20.2% in FY 2017, significantly outperforming the benchmark return of 18.7%.

Director Atwood continued his review by noting the Non-U.S. Equity portfolio gained 22.1%, net of fees, in FY 2017, outpacing the benchmark return of 20.4%, while the Hedge Fund of Funds portfolio significantly outperformed the benchmark return, 11.7% net of fees, compared to 6.5%. He reminded the Board that ISBI was in the process of reducing the Hedge Fund Allocation from 10% of the portfolio to 3% of the portfolio.

Director Atwood noted the Infrastructure portfolio returned 13.5% compared to the benchmark return of 5.7%. He added that the Real Estate portfolio returned 7.1%, behind the benchmark return of 7.6% and the Private Equity portfolio was slightly ahead of the 17.3% benchmark at 17.9%.

Director Atwood reported on actual asset allocation and target policy allocation. He noted that the Fixed Income Composite amounted to 28.7% of the portfolio, slightly under the policy allocation target of 30%. Director Atwood pointed out the Equity Composite equaled 49.7% of the portfolio, higher than the policy target of 43%, noting that much of this overweighting is due to the underweighting of private equity. He added that the Hedge fund of funds composite totaled 4.8%, ahead of the 3% benchmark, and noted the percentage will continue to decrease.

Director Atwood referred the Board to a document detailing the ISBI utilization of emerging and minority investment managers, as of June 30, 2017. He provided a

brief history of the issue as well as ISBI's actions and progress related to the program. As of June 30, 2017, 24.2% of the actively managed assets were managed by emerging and minority managers. This represents a steady increase since 2014, when the percentage totaled 21.2%.

Director Atwood then stated that 52% of U.S. Equity funds were traded through minority and female-owned brokerage firms, surpassing the goal of 30%. About 21% of international equities were traded through minority and female brokers, exceeding the goal of 20%, while 7% of international fixed income trades utilized minority and female brokers, exceeding the goal of 0-5%. Director Atwood concluded by noting 36% of Hedged Equity trades used such brokers, far exceeding the goal of 0-5%. He then mentioned that a majority of the minority and female-owned brokers utilized by ISBI are Illinois based.

Director Atwood then fielded questions and committed to providing the Board with data on the utilization of emerging and minority-owned firms broken down at the composite level contained in the quarterly fund evaluation report.

There being no further questions, Vice-Chairperson Morris asked for a motion to adopt the ISBI Quarterly Review. Trustee Silverthorn moved to adopt the ISBI Quarterly Review for the period ending June 30, 2017. Trustee Bates-Brown seconded the motion and it passed unanimously. A copy of the report is 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 Valuation. Mr. Rivera referred the Board to the FY 2017 Actuarial Valuation. He then began reviewing the key results of the valuation by stating that the state's contribution as a percentage of payroll for FY 2019 totaled 49.6%, up from 45.4% for the previous year. He also mentioned that the contribution rate reflected the "smoothing" component provided by Public Act 100-0023. Such component requires the fiscal impact associated with assumption changes to be spread over a 5 year period.

Mr. Rivera then discussed the actuarially determined contribution (ADC) which is to be used solely for financial reporting purposes and provides a better measurement of true cost. He reminded the Board the SERS ADC method was normal cost plus 23 years to amortize the unfunded liabilities, and added for FY 2019 totals 64.5% of payroll.

Mr. Rivera noted that active participation is declining and that if this trend continues in the future, the Board should consider making adjustments to the active population projections.

Mr. Rivera then compared the actuarial value of assets (AVA) with the market value of assets (MVA) for the year ended June 30, 2017. He mentioned that the market return for FY 2017 totaled 12.2% while the actuarial return totaled 8.0%. The actuarial return factors in smoothing of returns of the preceding 5-year period. The actuarial return exceeded the assumed rate of return for FY 2017, resulting in a small gain in the actuarial value of assets. Investment performance and other positive gains increased the funding ratio to 35.5% up from 34.4% from the prior year.

Mr. Rivera concluded his remarks by stating that the valuation does not reflect participation in the “hybrid plan” created for non-coordinated Tier 2 employees, as it is hard to predict participation rates. In addition, the impact is expected be minimal given the relatively few members that will eligible to participate in the plan. He stated that a sensitivity analysis had been conducted and supported this notion.

GRS consulting actuary Ryan Gunderson reviewed the analysis of the change in unfunded accrued actuarial liability. He pointed out the largest actuarial gains were due to positive investment performance, lower than projected salary increases, and retiree mortality experience. The biggest actuarial loss was due to contributions being less than total normal cost plus interest on the unfunded liability. Mr. Gunderson then directed the Board to charts in the valuation that illustrate the back-loaded nature of the statutory funding plan and that a large portion of investment earnings in the short term will be used for benefit payments.

After some discussion on the details of the valuation and financial condition of the fund, Trustee Silverthorn made a motion to approve the FY 2017 actuarial valuation and the preliminary certification of the FY 2019 State contribution. Trustee Dawson seconded the motion and the Board approved the motion unanimously. A copy of the valuation and contribution certification is made a part of these minutes as *Exhibit B*.

REPORT OF AUDIT & COMPLIANCE COMMITTEE

Chief Internal Auditor Casey Evans began the Audit and Compliance Committee report by stating that the committee met earlier that day. He added that they approved the minutes of the July 25th meeting. Mr. Evans reminded the Board that each trustee must complete a statement of economic interest and ethics training on an annual basis.

Mr. Evans provided a summary of the recent Qualified Illinois Domestic Relations Order (QILDRO) audit results. After providing a brief overview of the QILDRO provisions and the associated system procedures, he concluded that the results were clean. Mr. Evans summarized that the audit identified a minor weakness caused by the legacy system. Such weakness involved underpayments to survivors of members that had alternative payees at time of death. The audit department identified 19 survivors that had been underpaid due to faulty calculations produced by the legacy system which failed to recognize payments to alternate payees associated with a

QILDRO on file. The aggregate value of the underpayments totaled approximately \$54,000. Such beneficiaries have been made whole.

Mr. Evans then discussed a recent finding regarding survivor benefit payments to ineligible survivors. It was discovered that 8 survivors had been paid survivors' benefits despite acceptance of the survivor contribution refund by the member prior to death. Since the member accepted the refund and failed to repay prior to his or her death, such survivors were ineligible to receive such benefits. In all cases, benefits were stopped, and in some cases, the System would be able to collect prior overpayments. Such errors were caused by the legacy system.

Mr. Evans answered questions regarding weaknesses of the legacy system and commented that many of the weaknesses should be mitigated or eliminated in the next phases of the system modernization efforts. Upon the conclusion of that discussion, he completed his report by stating that the next scheduled meeting of the Audit and Compliance Committee would be January 9, 2018.

REPORT OF RULES AND PERSONNEL COMMITTEE

Jeff Houch stated that the October meeting of the Rules and Personnel Committee had been canceled. He added that the next meeting of the committee would take place at 2:00 pm on Monday, January 8th.

REPORT OF CHAIRPERSON MENDOZA

Chris Maley provided a report on behalf of the office of the Comptroller. Mr. Maley started his report by providing an update of the Debt Transparency legislation. HB 3649 had been vetoed by the Governor, but the House overrode the veto on October 25, 2017. The Senate is expected to do the same upon returning in early November. The Comptroller's office was preparing to implement the law in January in order to be able to report such data shortly thereafter.

Mr. Maley then provided a bill backlog update, mentioning that the backlog had tripled over the last two years. The General Assembly had recently authorized the issuance of \$6 billion in General Obligation bonds, which would be distributed in two separate sales. Though not finalized as of the date of the Board meeting, the week prior it had been agreed that \$1.5 billion would be sold in a competitive sale, while \$4.5 billion would be sold in a negotiated sale. The Comptroller's office expects to receive the proceeds in November. Once the office receives the proceeds, they would begin to aggressively pay down interest-bearing debt. Medicaid bills would receive priority due to the federal match component. Said different, by paying down those bills, the State would receive matching funds from the federal government. In addition, proceeds would be directed to pay outstanding State Group Insurance bills. Furthermore, bills with large amounts of late interest penalty debt would be targeted as well.

After some questions regarding the mechanics and allocation strategy of the bond issuance, Mr. Maley concluded his remarks.

Election of 2017 Vice-Chairperson. Vice-Chairperson Morris informed the Board that the election for Vice-Chairperson was required. Trustee Silverthorn made the motion to re-elect Trustee Morris as Vice-Chairperson and Trustee Allison seconded the motion. All trustees present voted in the affirmative.

2017 Executive Committee. Executive Secretary Blair indicated that elections for the Executive Committee were required. He mentioned the mechanics of the structure and indicated he would work with the Comptroller's office on her designee. Trustee Allison provided a motion to seat Trustee Morris to the elected position of the committee and to name Trustee Hawk as the alternate member of the committee. Trustee Silverthorn seconded the motion, and the motion passed unanimously.

2017 Audit and Compliance Committee. Executive Secretary Blair informed the Board that elections for the Audit & Compliance Committee were in order. Trustee Silverthorn made the motion to re-elect Trustee Morris and to elect Trustee Dawson to the committee. Trustee Bates-Brown seconded the motion, and all trustees present voted in favor of the motion.

Rules and Personnel Committee. Executive Secretary informed the Board of the need to elect three Trustees to the Rules and Personnel Committee. Nominations were taken, and Trustee Allison motioned to elect Trustees Latoza, Hawk, and Silverthorn to serve as members of the Rules and Personnel Committee. Trustee Bates-Brown seconded the motion, and the motion carried unanimously.

REPORT OF ANY TRUSTEE

Vice-Chairperson Morris asked if any trustee would like to offer a report. No trustee offered a report.

REPORT OF THE EXECUTIVE SECRETARY

Calendar Year 2018 Meeting Dates. In order to comply with the Open Meetings Act, it is necessary to post a schedule of meetings for the upcoming calendar year in the System's offices in Springfield and Chicago and on the SERS website. Trustee Allison moved to adopt the 2018 schedule, including the standing committees, as presented. The motion was seconded by Trustee Dawson and all voted in the affirmative for the 2018 meeting dates:

Tuesday, January 9, 2018
Tuesday, April 24, 2018
Tuesday, July 24, 2018
Tuesday, October 30, 2018

All 2018 meetings will begin at 10 a.m. The System's Springfield office is located at 2101 South Veteran's Parkway. The Chicago meeting location is Room N-703 of the Bilandic Building, 160 N. LaSalle St. All meetings will be available via videoconference at both locations.

FY 2018 Funding Update. Executive Secretary Blair informed the Trustees that SERS had received the November contribution and that funding for FY 2018 was current.

Reappointment of Alan Fowler. Executive Secretary Blair noted that Alan Fowler, Accounting Division Manager, had been serving in his role for the last four years. The position is a four-year term, and the current term is expiring. Secretary Blair asked for the Board's approval of a new four-year term for Mr. Fowler effective December 16, 2017. Trustee Silverthorn made the motion, Trustee Allison seconded the motion, all voted in the affirmative.

REPORT OF ACCOUNTING DIVISION MANAGER

Alan Fowler, Accounting Division Manager, began by reporting on the financial statements for the fourth quarter of FY 2017 ending June 30. Mr. Fowler noted that the report contains normal variances. The variances were caused by the timing of the receipt of the GRF portion of employer contributions, the sale of some invested assets to cover disbursements, and the increase in benefit payments primarily attributed to automatic annual increases.

Mr. Fowler thanked the Comptroller's Office staff and mentioned that payments were up to date through November, which means the System will be able to pay benefits for the month without having to draw down any invested assets.

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

APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the July, August, and September 2017 Executive Committee minutes for review. There being no changes to the minutes, Trustee Allison moved to approve the minutes as presented. Trustee Bates-Brown seconded the motion, which prevailed by the affirmative vote of all present.

OLD BUSINESS

Vice-Chairperson Morris asked if there was any old business to consider. There was no old business.

NEW BUSINESS

Vice-Chairperson Morris asked if there was any new business to consider. Executive Secretary Blair stated that Kevin Rademacher would continue to serve as the IT Division Manager while also functioning as the Chief Information Security Officer.

Mr. Rademacher gave a brief update of the IT modernization status by stating that the project had been divided into teams working on Benefits Setup, Service Purchase and Accounts Receivable.

Mr. Rademacher added that October is Security Awareness Month and staff had been provided with several opportunities for security awareness training throughout the month. He also stated that the IT Division is working to enhance security procedures and to replace the security infrastructure for the system.

Mr. Rademacher concluded his report by stating that staff hours would be taken away from the IT modernization project in order to work on CMS benefits and issues with Morneau Shepell.

ADJOURNMENT

There being no further business to be brought before the Board, Vice-Chairperson Morris called for a motion to adjourn. Trustee Bates-Brown moved to adjourn and Trustee Silverthorn seconded the motion. All members voted in the affirmative and the meeting adjourned at 12:00 p.m. Vice-Chairperson Morris reminded the Trustees that the next meeting is scheduled for January 9, 2018, at 10 a.m. in the Springfield Office with the usual videoconference location in the Bilandic Building.

David Morris, Vice-Chairperson

Date: _____

ATTEST:

Timothy Blair, Executive Secretary

Date: _____