

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF TRUSTEES

April 8, 2014

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, April 8, 2014, at 10:00 a.m. in the System's Springfield office located at 2101 South Veterans Parkway with a videoconference location at the Bilandic Building, Room N-703, 160 North LaSalle Street, Chicago, IL.

The following trustees were in attendance:

Judy Baar Topinka, Chairperson
Lori Laidlaw, Vice Chairperson
Shirley Byrd, Trustee
David Morris, Trustee
Patricia Ousley, Trustee
Patricia Rensing, Trustee
Thomas Allison, Trustee
Renee Friedman, Trustee
Danny Silverthorn, Trustee

Absent:

Harold Sullivan, Trustee

Others in attendance were:

Timothy Blair, Executive Secretary
Steve Bochenek, Attorney
William Atwood, Director, Illinois State Board of Investment
David Kausch, Consulting Actuary, Gabriel, Roeder, Smith & Co.
Paul Wood, Consulting Actuary, Gabriel, Roeder, Smith & Co.
Alex Rivera, Consulting Actuary, Gabriel, Roeder, Smith & Co.
Craig Goesel, Mesirow Financial Insurance Services
Tim Bowen, Mesirow Financial Insurance Services
Tom Davis, Davis-American, Ltd.
Jeff Sychowski, Davis-American, Ltd
Alan Fowler, Manager, Accounting Division
David O'Brien, Manager, Administrative Services Division
Gerry Mitchell, Chief Information System Officer
Alexis Sturm, Office of the Comptroller
Barbara Baird, Manager, SERS Chicago Office
Jennifer Staley, Recording Secretary
Alan Latoza, SERS member
Tia Sawhney, SERS member

Chairperson Topinka presided and called the meeting to order at 10:05 a.m. with a quorum present.

PUBLIC COMMENTS

Chairperson Topinka asked if there were any members of the public in either the Springfield or Chicago location who wished to address the Board. Tia Goss Sawhney, SERS member and a member of the Department of Healthcare and Family Services Executive Staff, introduced herself and addressed the Board, noting she is one of four actuaries employed by the State of Illinois and very involved in the professional standards of the American Academy of Actuaries.

Ms. Sawhney stated that SERS is a financially troubled pension plan and noted that the Board was not responsible for the current situation but is in the current situation. She continued that she had carefully looked into the financial situation of the State-funded plans for about six months. She said the lack of clear communication is very disappointing and stated that communication is the responsibility of the Board. Ms. Sawhney opined that the Board could better communicate the financial condition of SERS to members, taxpayers and bondholders.

Ms. Sawhney concluded by calling upon the Board of Trustees, and the Board's actuaries, to do a much better job of communicating the financial status of SERS and the long term risks associated with SERS. Chairperson Topinka asked if Ms. Sawhney had any recommendations or suggestions for the Board. Ms. Sawhney offered to compile her suggestions for presentation to the Board at the July meeting.

ELECTED ANNUITANT TRUSTEE APPOINTMENT

Trustee Virginia Yates, elected annuitant Trustee, passed away in November 2013. Her term was set to expire July 2, 2014. Alan Latoza, SERS retiree, is the only candidate for the elected annuitant trustee term beginning July 2, 2014. Vice Chairperson Laidlaw made a motion to appoint Mr. Latoza to complete Trustee Yates term. Trustee Rensing seconded the motion and all were in favor. Mr. Latoza was added to the roll as a Trustee for the remainder of the meeting.

REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT (ISBI)

William Atwood, ISBI Director, distributed copies of the Executive Summary for the period ending February 28, 2014, and addressed the Board. He began by noting the entire portfolio returned 13.1% (net of fees) for the eight months ended February 28, 2014, while the benchmark returned 11.2% over the same time period.

Director Atwood continued by noting that over that time period, the Fixed Income portfolio returned 3.8% and the U.S. Equity portfolio, excluding Hedge Funds, returned 19.0%. Both portfolios outperformed their benchmarks, which returned 3.0% and 18.8%, respectively. Mr. Atwood continued by briefly reviewing the returns of several more asset classes, noting that most asset classes had outperformed the respective benchmark.

Director Atwood informed the Board that the markets have generally declined since February 28th and that between January 1st and March 31st the equity markets have declined. He also noted the ISBI required two managers on the watch list, William Blair and Segal Bryant & Hamill, to make a personal appearance and report to the Board. Since the last ISBI meeting, Segal Bryant & Hamill have been removed from the watch list and the Board will consider William Blair at the June meeting.

Chairperson Topinka asked if there were any additional questions. There were none. A copy of the report is maintained in the ISBI office and made a part of these minutes as Exhibit A. Chairperson Topinka thanked Director Atwood for his informative report and excused him from the remainder of the meeting.

REVIEW OF ACTUARIAL ASSUMPTIONS

David Kausch, Alex Rivera and Paul Wood of Gabriel, Roeder, Smith & Company, Consulting Actuaries, distributed the 2014 Experience Review for the 4 year period ended June 30, 2013. Mr. Wood started the presentation by explaining the purpose of the review is compare assumptions with actual experience in order to validate current assumptions or recommend changes as needed, as well as measure the financial impact of recommended changes.

Mr. Wood noted there are economic assumptions and demographic assumptions. Economic assumptions include investment return, inflation, payroll growth and individual salary increase rates. Demographic assumptions include retirement, termination, death and disability rates. He added that each assumption should be individually reasonable and consistent with other assumptions.

In reviewing the economic assumptions, Mr. Wood recommended maintaining the inflation rate at 3% while lowering the wage growth assumption from 4% to 3.5%, recognizing a slower growth in actual total payroll. He also recommended slightly decreasing individual salary increases assumptions due to recent increases being lower than previously assumed.

Continuing with the review of economic assumptions, Mr. Wood noted the Board lowered the investment return assumption from 8.5% to 7.75% for the June 30, 2010 valuation. He then reviewed the methodology used in projecting the probability of achieving 7.75%, 7.5% and 7.25% over the next 30 years. He noted the probability of achieving 7.75% over the long term is 34.0%, while the probability of achieving 7.5% and 7.25% is 38.1% and 42.3%, respectively. Trustee Friedman asked if we should strive for a 50% possibility. Mr. Kausch answered that according to the Actuarial Standards of Practice (ASOP), an economic assumption has been considered reasonable if it falls between the 25th to 75th percentiles. Mr. Kausch added the ASOP has been modified to try to narrow the range to between the expected median return of 6.82% and the average return of 7.52%.

Mr. Wood continued by noting the State Actuary had recommended lowering the rate to 7.25%. He said based on the review, GRS recommended lowering the assumption to 7.25% or 7.5% and closely monitoring the assumption, as it would be affected by a change in asset allocation or a change in funding policy. Trustee Allison asked if SB 1 were overturned a year from now would the investment return assumption be affected. Mr. Wood clarified that if the financial condition of the system were better the investment return assumption could be less conservative. The additional funding in SB 1 may allow for less conservatism in the future, but there is concern over the funding provision due to the litigation challenging constitutionality.

Mr. Wood continued his review by directing the Board's attention to the analysis of demographic assumptions. He recommended an update in the mortality assumption to reflect longer life expectancy. Mr. Wood then reviewed the suggested changes in retirement rates. For regular formula employees, he recommended extending age-based assumed rates to age 75 and increasing the rates at earlier ages and decreasing the rates at later ages. For alternative formula members, Mr. Wood recommended extending the age-based assumed rates to

age 72. For male members, the recommendation was to increase rates for ages under 68 and decrease later rates. For female members the rates would increase between ages 62 and 67 and decrease rates for ages under age 62 and over age 67.

Mr. Wood added there needed to be separate assumptions added for Tier 2. He noted that there haven't been any Tier 2 retirements and recommended the adoption of retirement rates that are consistent with the age-based assumptions for Tier 1 regular and alternative formula members. Mr. Wood recommended minor changes to the turnover rates assumption and increasing the annual cost from 1% of payroll to 1.34% of payroll and adding a load of 15% of the liability for inactive members eligible for deferred vested benefits.

Mr. Wood pointed out for the Board that changing only the demographic and salary assumptions would have increased the FY 15 certified contribution from \$1.748 billion to \$1.841 billion. Trustee Allison asked what the impact would be to the State in lowering the investment return assumption. Mr. Wood pointed out adopting all recommended assumptions, including the 7.25% investment return, would have resulted in additional State contributions of almost \$200 million in FY 15. In addition, the funded ratio would decline from about 35.7% to approximately 33.1%.

Mr. Wood noted that total employer contributions to SERS would increase from \$90.4 billion to \$93.6 billion with a 7.5% assumption and \$96.2 billion with a 7.25% assumption. He added that on a present value basis, total employer contributions would increase from \$28.5 billion to \$30.4 billion with a 7.5% assumption and \$32.1 billion with a 7.25% assumption.

After a few questions regarding peer group assumptions, Trustee Rensing moved to set the interest rate assumption at 7.25%. Vice-Chairperson Laidlaw seconded the motion and all were in favor. Trustee Ousley moved to adopt the rest of the assumptions as recommended and Trustee Silverthorn seconded the motion, which passed unanimously. Chairperson Topinka thanked Mr. Rivera, Mr. Wood and Mr. Kausch for the presentation and excused them from the remainder of the meeting.

FIDUCIARY LIABILITY PRESENTATIONS

Craig Goesol and Tim Bowen of Mesirow Financial Insurance Services introduced themselves to the Board. Mr. Goesol started the presentation by clarifying that Mesirow is an insurance broker based in Chicago. He noted that Mesirow is the largest fiduciary liability insurance broker for Illinois pension funds, with 175 pension fund clients in Illinois, including SURS, and other funds throughout the nation. He then pointed out that Mesirow has a dedicated claim advocacy group.

Mr. Goesol referred the Board to a copy of the procurement letter that was sent to insurance companies requesting quotes for SERS renewal coverage and the responses of all companies. Only three carriers were interested in offering renewal terms to SERS, with ULLICO/Alterra providing the most favorable terms. Mr. Bowen continued the presentation by briefly reviewing the responses of the various companies and the provisions and exclusions of the selected ULLICO policy. He specifically noted the Employments Practices Liability Coverage provision and the Choice of Counsel provision. In addition, Mr. Bowen explained the Consent to Settle Clause had been removed from the proposed ULLICO policy and that other significant provisions in the ULLICO proposal included Cyber Security Coverage and Over-Payment of Benefits Coverage. Mr. Bowen continued by pointing out some of the relevant policy exclusions and offered to answer questions.

Mr. Goesel referred the Board to the pricing options for various levels of coverage, ranging from \$5 million in coverage to \$25 million in coverage, with ULLICO being the lead carrier for all coverage levels. He noted the annual renewal premium for the \$5 million coverage option is \$239,502, or about \$110,000 less than the current premium for the same level of coverage. Mr. Goesel then offered the level of coverage should probably be higher than \$5 million and noted the current renewal proposal from ULLICO would provide \$10 million in coverage for \$16,000 less than the cost of the current \$5 million policy.

Trustee Allison asked Mr. Goesel why SERS would need \$10 million in coverage if the Board is statutorily indemnified. Mr. Bowen responded the State statute provides that SERS “may” indemnify the Trustees, rather than “shall” indemnify the Trustees. Chairperson Topinka asked if there were any additional questions. There were none. Chairperson Topinka thanked Mr. Goesel and Mr. Bowen for the presentation and excused them from the remainder of the meeting.

Following the Mesirov presentation, Mr. Bochenek provided that in addition to the indemnity provision in the Pension Code, there is also a statutory Indemnity Act. He said that he would review the Act and report to the Board and reminded the Trustees that the System had chosen to indemnify the Trustees, even though it is not required by the Pension Code. Chairperson Topinka instructed Secretary Blair to work on legislation that would statutorily require SERs to indemnify the Board.

Tom Davis and Jeff Sychowsky of Davis American introduced themselves to the Board. Mr. Davis started the presentation by thanking the Board for the opportunity to provide fiduciary liability insurance to the Board for the prior 3 years. He continued by reviewing the proposed policy, which provided \$5 million in coverage for \$198,024, more than \$151,000 less than the annual premium of the current policy.

Mr. Sychowsky continued the presentation by reviewing the provisions and exclusions of the proposed Hudson policy. He noted the policy had no Consent to Settle Clause and explained to Trustee Allison the Sovereign Immunity Clause, which provides the Hudson policy will pay for Trustee defense immediately, even if the Board has statutory indemnity from the State. Mr. Sychowsky then reviewed the proposed pricing schedule for the Board, which provided for \$10 million in coverage for an annual premium of \$321,184. Trustee Allison asked what Mr. Davis would consider an adequate amount of coverage. Due to the possibility of class action litigation given the size of SERS, Mr. Davis answered that he thought coverage of more than \$5 million would be appropriate.

Chairperson Topinka asked if there were any additional questions. There were no additional questions and Chairperson Topinka excused Mr. Davis and Mr. Sychowsky from the remainder of the meeting.

Chairperson Topinka asked Mr. Bochenek if he had any comments on the competing policies. Mr. Bochenek answered that he had reviewed both policies as presented to the Board. He commented that the Davis proposal does include the Sovereign Immunity provision and the Consent to Settle clause had been excluded. He opined that the Sovereign Immunity provision in the Hudson policy is the significant difference in the two proposals. Trustee Friedman agreed and offered that the level of coverage should be increased from the current \$5 million level. She then offered a motion to accept the Davis American proposal at the \$10 million policy level. Vice Chairperson Laidlaw seconded the motion and all were in favor.

Trustee Allison asked to be excused for the remainder of the meeting and Chairperson Topinka granted permission.

MINUTES OF THE JANUARY 8, 2014 BOARD MEETING

The minutes of the Board meeting held January 8, 2014 were presented to the members by Chairperson Topinka. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Ousley moved to approve the minutes as submitted. Trustee Morris seconded the motion and all were in favor.

REPORT OF CHAIRPERSON TOPINKA

Chairperson Topinka had nothing to report, except to note the legislature was in session and being monitored closely by the Comptroller's Office and SERS.

REPORT OF ANY TRUSTEE

Chairperson Topinka asked if any other trustees would like to offer a report. No other trustee offered a report.

REPORT OF RULES AND PERSONNEL COMMITTEE – TRUSTEE RENSING

Trustee Rensing, Chairperson of the Rules and Personnel Committee, reported the Committee had met the previous day. She commended SERS on the recent hiring in the IT Division, including the hiring of several IT interns. She also reported the System had entered into a Memorandum of Understanding with AFSCME regarding the use of personal service contracts and that the Policy Manual had been finalized. Trustee Morris offered a motion to accept the report. The motion was seconded by Vice Chairperson Laidlaw and all were in favor.

REPORT OF AUDIT AND COMPLIANCE COMMITTEE – TRUSTEE FRIEDMAN

Trustee Friedman stated there was nothing yet to report as the committee meeting was just held that morning and was mainly organizational in nature. She offered to provide a full report to the Board at the July meeting. Chairperson Topinka and the rest of the Trustees agreed.

REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Ethics. Gerry Mitchell, CISO and Ethics Officer, reminded the Board the annual Statements of Economic Interest are due to the Secretary of State's Office by May 1, 2014. He also reported the annual ethics training is approaching. This is paper-based training that requires a signature when the training has been completed and will be mailed to all Trustees. Vice Chairperson Laidlaw asked if the employee ethics training would suffice for the Board training. Mr. Mitchell responded the employee ethics training is different than the Board member training. Current statute requires all Trustees to complete Trustee ethics training.

Systems Modernization. Mr. Mitchell continued by informing the board that progress continues on the re-engineering of the active member system, including the development of an employer website and the implementation of a new benefits calculation screen. Newly re-designed inactive statements have been distributed and work is underway for the redesigned retiree statement. Both of these statements are stored in the system in PDF format to allow

for reprinting or emailing. Mr. Mitchell reported the VOIP project has been delayed until FY 15 due to scheduling problems with CMS.

Medicare Advantage. Mr. Mitchell reported all IT system changes have been implemented for Medicare Advantage.

Pension Reform. The System continues to prepare for the implementation of pension reform. Meetings were held with the Comptroller's Office regarding system interface file changes and dates for testing. Secretary Blair has been researching the various union contracts and their expiration dates in order to help in the earnings limitation calculation. Most current contracts appear to be expiring in June 2015.

Mr. Mitchell also reported that CMS has agreed to allow the use of their electronic pay stub system (EPASS) for retirees in order to implement the law that requires the elimination of paper based pay stubs and earnings statements, effective July 1, 2014.

Business Continuity/Disaster Recovery Planning. Mr. Mitchell noted the building generator has been tested and brought online. It will be tested twice a month.

Risk Assessment. The System continues its remediation efforts from the recent risk assessment. The bid for lockable doors in the Accounting Division and Administrative Services Files has been awarded. Plans are underway to upgrade the interview booths for better privacy. IT has been upgrading all agency PCs to be encrypted and work is underway to encrypt the System's databases.

Staffing. Mr. Mitchell reported that good progress has been made in the hiring of IT staff with the addition of three IT interns and a full-time employee.

REPORT OF THE EXECUTIVE SECRETARY

Secretary Blair presented the preliminary FY 15 budget for review. He first noted the FY 15 budget request is 3.47% lower than the FY 14 budget. Several factors have allowed the FY 15 decrease, including a reduction in the amount of IT equipment that must be purchased for the modernization efforts, the completion of several facility maintenance projects, and a slight decrease in the requested IT headcount.

Secretary Blair added that he expects the final FY 15 budget to be presented at the July meeting will contain further reductions in certain line items. Chairperson Topinka asked if there were any questions. Trustee Morris asked how many merit compensation (MC) employees were at SERS and if there were any pay increases budgeted for them. Secretary Blair answered there are fewer than 12 MC employees and there were no regular budgeted pay increases included in the preliminary FY 15 budget request. He noted there had been no actual pay plan for MC employees since 2009.

Hearing no further questions, Chairperson Topinka asked if there was a motion to approve the preliminary FY 15 budget. Trustee Morris moved passage of the budget as presented. The motion was seconded by Trustee Ousley and all members voted in the affirmative.

LITIGATION UPDATE

Chairperson Topinka announced the next item of discussion was the Litigation Update. Secretary Blair offered the item could be discussed in an open session, even though the agen-

da included it as a closed session item. Vice Chairperson Laidlaw asked to speak to the topic. She noted the uncertainty created by the litigation challenging the constitutionality of SB 1 is causing a hardship to the members, beneficiaries and staff of SERS. She cited previous discussions regarding injunctive relief as the best possible solution for all stakeholders, in order to allow the courts to address the constitutionality questions prior to implementation.

Vice Chairperson Laidlaw cited the problems that would occur in lowering the employee contribution and then having the law overturned, and the issues associated with the escrowing of employee contributions. She then submitted a resolution for consideration. The resolution requests the Attorney General ask the Court for injunctive relief pending the outcome of all litigation pertaining to SB 1. If the Attorney General declines to ask for injunctive relief, the resolution requests that SERS be allowed to procure outside counsel.

Steve Bochenek added that injunctive relief may be the best option for the System, but that the Attorney General may not be in the best legal position to request that relief, as the primary function of the Attorney General is to defend the constitutionality of the law. Trustee Friedman agreed but added that even if there is only a small chance the law is eventually overturned, we need to be fully aware of that possibility and the consequences. Effectively, if the bill is eventually overturned, there would be several administrative problems in “unimplementing” the reduced employee contribution rates and reduced COLAs.

Chairperson Topinka asked Vice Chairperson Laidlaw to read the resolution to the Board. Vice Chairperson Laidlaw then moved to adopt the resolution. The motion was seconded by Trustee Morris and on a roll call vote all Trustees voted in the affirmative. Secretary Blair was instructed to draft a cover letter and forward the unanimous resolution to the Attorney General and all Trustees, and to put a copy of the resolution on the SERS website. The resolution is made a part of these minutes as Exhibit B.

SECOND QUARTER FINANCIAL STATEMENTS

Alan Fowler, Accounting Division Manager, presented the financial statements for the second quarter of FY 14. Mr. Fowler noted that in comparison to the last quarter of FY 13, there was a decrease in employer contributions of approximately \$63.5 million, due mainly to differences in the timing of GRF contributions. He also noted that retirement annuities increased by \$26.9 million when compared with the same quarter of the previous fiscal year. This is typical and generally the result of the statutory 3% COLAs provided to retirees in January and an increase in the number of retirees from the previous year.

Mr. Fowler then noted the implementation of the Intergovernmental Transfer Program (ITP) with the Comptroller’s Office. The GRF employer contributions that have been coming to the system by paper check are now deposited into the Trust electronically. Chairperson Topinka then asked if there were any questions. There being no questions, Trustee Rensing moved to accept the first quarter financial statements and Trustee Ousley seconded the motion, which passed unanimously. Copies of these financial statements are attached to these minutes as Exhibit C.

APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the January and February 2014 Executive Committee minutes for review. There being no changes to these minutes,

Trustee Rensing moved to approve. Vice Chairperson Laidlaw seconded the motion, which prevailed by the affirmative vote of all trustees.

OLD BUSINESS

Chairperson Topinka asked if Secretary Blair had considered having a Board meeting with all Trustees in one location, rather than using the videoconference option. He offered a few options and it was decided that annually the July Board meeting would be held in Chicago and the October Board meeting would be held in Springfield. The January and April Board meeting would continue to utilize the videoconference option at both locations, beginning with the July 15, 2014 Board meeting to be held in Chicago.

NEW BUSINESS

Chairperson Topinka asked if there was any new business to be brought before the Board. Secretary Blair presented to the Board a retirement resolution for Trustee Rensing, who is retiring from the Illinois Department of Corrections on May 1, 2014, and also leaving the Board of Trustees. He read the resolution to the full Board. Vice Chairperson Laidlaw moved to adopt the Rensing retirement resolution. Chairperson Topinka seconded the motion and all were in favor. The resolution is made a part of these minutes as Exhibit D.

ADJOURNMENT

There being no further business to be brought before the Board, Trustee Ousley moved for adjournment at 12:25 p.m. The adjournment was seconded by Trustee Morris and all were in favor.

Judy Baar Topinka, Chairperson

Date: _____

ATTEST:

Timothy Blair, Executive Secretary

Date: _____