

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

MINUTES OF THE REGULAR MEETING  
OF THE BOARD OF TRUSTEES

January 14, 2014

A regular meeting of the Board of Trustees of the State Employees' Retirement System of Illinois convened on Tuesday, January 14, 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  
David Morris, Trustee  
Patricia Ousley, Trustee  
Patricia Rensing, Trustee  
Thomas Allison, Trustee  
Renee Friedman, Trustee  
Danny Silverthorn, Trustee

Absent:

Shirley Byrd, Trustee  
Harold Sullivan, Trustee

Others in attendance were:

Timothy Blair, Executive Secretary  
Steve Bochenek, Attorney  
William Atwood, Director, Illinois State Board of Investment  
Paul Wood, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Alex Rivera, Consulting Actuary, Gabriel, Roeder, Smith & Co.  
Alan Fowler, Manager, Accounting Division  
Gerry Mitchell, Chief Information System Officer  
Alexis Sturm, Office of the Comptroller  
Barbara Baird, Manager, SERS Chicago Office  
Jennifer Staley, Recording Secretary  
Tia Sawhney

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. There were no public comments.

REPORT OF THE ILLINOIS STATE BOARD OF INVESTMENT

William Atwood, Director of the Illinois State Board of Investment (ISBI) distributed copies of the Pension Fund Executive Summary for the period ending November 30, 2013,

and addressed the Board. He began by reviewing the returns of the various asset classes for the one year period ended November 30, 2013. Director Atwood noted the entire portfolio returned 18.6% (net of fees) over that period, while the benchmark returned 15.8%.

Director Atwood continued by noting that over the year ending November 30, 2013, the Fixed Income portfolio returned 1.5% and the U.S. Equity portfolio, excluding Hedge Funds, returned 34.4%. Both portfolios outperformed their benchmarks, which returned -0.9% and 31.7%, respectively. Mr. Atwood continued by briefly reviewing the returns of several asset classes, noting that most asset classes had outperformed the respective benchmark and that the positive returns had continued through December, with the total portfolio returning 20.8% over the one year period ending December 31, 2013.

Director Atwood informed the Board the value of the portfolio as of December 31, 2013 was \$14.2 billion, up from \$12.9 billion at June 30, 2013 and \$11.3 billion at June 30, 2012. So in the 18 months following June 30, 2012, the portfolio grew from \$11.3 billion to \$14.2 billion. He then noted that even though the performance of the portfolio has been very positive recently, the markets won't always provide the consistent positive returns and that a "give back" will occur during some periods of the business cycle.

Director Atwood announced that he had concluded his report and Chairperson Topinka asked if there were any questions. Trustee Allison asked about the termination of Amalgamated as a debt manager. Mr. Atwood replied the Amalgamated was an alternative debt platform and had been terminated some time ago. He continued by stating that home mortgages and construction loans in the economic downturn were converted to equity, which is not good for the portfolio. The funds that were invested in Amalgamated are being returned and the Board has moved Amalgamated from the fixed income portfolio to the real estate portfolio. Trustee Allison then asked if ISBI had terminated ULLICO. Director Atwood replied that ULLICO had not been terminated.

Trustee Friedman asked in the valuation terminology what "in compliance" specifically means. Director Atwood replied that "in compliance" means that everything is going well. He further noted that a manager could also be "on alert" or "on notice." Trustee Friedman then asked who decides if a manager is "in compliance." Director Atwood answered that ISBI makes that determination. Director Atwood explained that under Board policy if a manager underperforms they go on "watch." A manager may also go on watch if there is a change of ownership, if key people leave the firm, or if the portfolio starts behaving in a manner inconsistent with expectations. At that point, ISBI staff advise the Board that the manager is "on watch" or "on alert." At the next meeting ISBI staff presents to the Board the issue and the Board has a year to decide whether to take the manager off the watch list or terminate the manager.

Trustee Friedman asked about who oversees this process. Director Atwood replied the real estate portfolio is overseen by staff and by the real estate consultant. The private equity portfolio is reviewed and monitored by ISBI staff. Trustee Friedman then asked if staff is actually going behind the scenes to review the ULLICO report? Director Atwood replied in the affirmative and noted the review is completed down to the level of examining individual positions and whether those positions are consistent with contract guidelines of what a manager can and cannot hold. Effectively, every manager is monitored on a monthly basis and audited quarterly. Chairperson Topinka asked if there were several people overseeing the portfolios.

Director Atwood assured her it was overseen on several levels and that ISBI monitors the portfolio aggressively.

Chairperson Topinka asked if there were any other questions for Director Atwood. Hearing none, she asked Mr. Atwood that since the ISBI portfolio is doing so well right now, shouldn't ISBI somehow protect some of the significant investment gains? Director Atwood replied the ISBI portfolio has been constructed based on an asset allocation model. Because of the performance of the various assets classes, the ISBI portfolio is currently long on domestic and international stocks and short on bonds when compared to the asset allocation model. These gains will be locked-in as the portfolio is re-balanced by liquidating some securities from the outperforming asset classes.

Chairperson Topinka again asked if there were any other questions for Director Atwood. Trustee Friedman asked Director Atwood if he has looked at the State Actuary's report. He mentioned that he had briefly reviewed the summary. Trustee Friedman pointed out the summary recommends that SERS lower the investment return assumption to 7.25% and then asked how Director Atwood felt about that. Director Atwood replied that he looks at the return assumption differently than most people do. He looks at assumption as being directly related to the amount of volatility the Board will tolerate. He further explained that if the Board lowers the return assumption from 7.75% to 7.25%, the Board is saying it wants to reduce the volatility of the portfolio. But by doing that there is a cost to be paid by lowering the long-term return. A much higher burden is shifted to the taxpayer.

Director Atwood stated that he is very confident the portfolio will achieve a 7.75% annual rate of return over the course of the business cycle, if the Board is prepared to accept a certain level of volatility. He noted that volatility is only material if you have to withdraw money from the portfolio. On a day to day basis you don't care if there is market fluctuation. If there will be no significant withdrawals from the portfolio, the volatility issue is just not that meaningful. He noted that as a fiduciary, he's reasonably confident he can continue to achieve 7.75% as long as the Board understands there will be a certain amount of volatility.

Trustee Allison then asked if the ISBI would make any changes in the investment portfolio if the SERS Board changed the investment from 7.75% to 7.25% as recommended by the State Actuary. Director Atwood responded there would be only a marginal change in asset allocation. Trustee Allison then noted that he looked at a change in the actuarial rate as a way of getting more money into the system and therefore increasing long term security.

Chairperson Topinka asked if there were any additional questions. There being none, Trustee Rensing moved to accept the ISBI Report for the period ending November 30, 2013. Trustee Friedman 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 thanked Director Atwood for his informative report and excused him from the remainder of the meeting.

#### REPORT OF THE ACTUARY

Alex Rivera and Paul Wood of Gabriel, Roeder, Smith & Company, Consulting Actuaries, distributed the final version of the June 30, 2013 actuarial valuation. Mr. Rivera started the presentation by noting the valuation results were essentially the same as presented at the October Board meeting. The final report was changed to incorporate the suggestions of the State Actuary, which amounted to adding some disclosures, including one regarding the ac-

tual retirement experience over the last few years. Mr. Rivera then noted the final employer certification amount is consistent with the draft copy that was provided to the Board at the October meeting.

Mr. Rivera continued by providing an overview of the comments of the State Actuary. He noted the comments really covered four key areas, the interest rate assumption, the adoption of a generational mortality table, the adoption of an asset corridor, and additional disclosures, including retirement experience.

Mr. Rivera first noted the State Actuary recommended the assumption should be reduced from 7.75% to 7.25%. He stated that he believes the current assumption of 7.75% is appropriate and reasonable, but that he would recommend the Board review the assumption, taking into consideration the likelihood of achieving alternative investment returns. Based on the likelihood of achieving the various rates of return, the Board could decide which investment return assumption is appropriate.

Trustee Friedman asked Mr. Rivera about the accounting principles that are changing in 2015, if the change should affect the assumption and that maybe a 7.75% investment return assumption wouldn't be as reasonable. Alex responded that he didn't agree with that comment and noted so in the response to the State Actuary. He explained the 2015 change is really in the Actuarial Standards of Practice (ASOP) regarding the reasonableness of achieving a certain long-term return. If there is a strong likelihood of achieving that return, then it would be deemed reasonable.

Trustee Allison then asked Mr. Rivera if he considers both 7.25% and 7.75% to be reasonable. Mr. Rivera responded that he thought there is a range of reasonableness and he would be comfortable performing an evaluation with either of those different investment return assumptions. He noted the Board shouldn't be overly aggressive with the investment return assumption but that there was no need to be overly conservative either. Mr. Rivera noted there is a "sweet spot." Trustee Allison noted it is Mr. Rivera's job to help the Board figure out what that is and he mentioned it sounds like Mr. Rivera may consider 7.75% to be the "sweet spot."

Mr. Rivera responded that he didn't necessarily think that. He pointed out that in the last study, 7.75% was within the range of reasonableness. He then recommend for the next valuation cycle we gather more data, look at the likelihood of achieving various rates of return and review the ASOPs to make sure we are still in compliance. After this type of analysis it may turn out that the "sweet spot" may be closer to 7.5% or 7.75%.

Trustee Allison responded that it sounded like Mr. Rivera is suggesting that the Board not act prematurely on the State Actuary's recommendation to lower the investment return assumption to 7.25%. Mr. Rivera responded in the affirmative by citing the need for more data, including information from ISBI and capital market assumptions from investment managers. A full analysis could then be performed. Chairperson Topinka asked if that type of analysis could be presented at the next meeting of the Board in April and Mr. Rivera said that it could.

Chairperson Topinka asked Mr. Rivera what his best guess was as to what the analysis might show. He answered that it would be reasonable to expect a slight decline in the rate.

Trustee Friedman asked that if changing the return assumption really doesn't change the investment portfolio, but brings more money into the system, maybe the Board should consider an even lower rate, in order to be more conservative. Mr. Rivera responded that conservative is fine as long as the assumption is in the range that would be compliance with the ASOP.

Mr. Rivera noted in selecting the investment return assumption, the Board may also consider Director Atwood's comment regarding the burden to the taxpayer. Trustee Friedman responded by saying that in her job as a trustee, she didn't want to think of the SERS trust any differently than she would for her own retirement and that she considered herself pretty conservative. She added that she didn't see funding SERS conservatively as a burden but rather as providing financial security for the System. Mr. Rivera responded the job of the actuary is to provide all relative information to the Board and that ultimately it is up to the Board to decide on the best option.

Chairperson Topinka asked Executive Secretary Blair if the number of retirements had increased due to the passage of Senate Bill 1. Executive Secretary Blair responded that the number of retirements and the requests for retirement estimates had increased. He noted the effective date of the bill is June 1, 2014 and members are interested in changing their employment status from "active" to "retired" before that effective date of the bill. There is some belief that that difference in retirement status will make a difference going forward in the various challenges to the constitutionality of the law.

Chairperson Topinka asked Mr. Rivera to comment on the increase in retirements. Mr. Rivera noted that it's time to perform an experience study on all assumptions, including the retirement experience and the mortality assumptions. He noted the State Actuary had recently recommended the adoption of a generational mortality table. After a question from Trustee Allison, Mr. Rivera explained a generational mortality table reflects future increases in life expectancy. He provided the example of a 50 year old today versus an individual who will turn 50 ten years from now; the latter individual should have a longer life expectancy.

At the conclusion of the presentation, Trustee Friedman made a motion to approve the FY 2013 actuarial valuation and to certify the FY 2015 Sate Contribution amount of \$1.748 billion, or 40.472% of payroll. Trustee Ousley seconded the motion and all were in favor. Chairperson Topinka thanked Mr. Rivera and Mr. Wood for the informative presentation and excused them from the remainder of the meeting.

#### MINUTES OF THE APRIL 16, 2013 AND OCTOBER 29, 2013 BOARD MEETINGS

The minutes of the Board meetings held April 16, 2013 and October 29, 2013 were presented to the members by Chairperson Topinka. Copies of these minutes were previously provided to each trustee for preliminary review. Trustee Rensing moved to approve the minutes as submitted. Trustee Silverthorn seconded the motion and all were in favor.

#### REPORT OF CHAIRPERSON TOPINKA

Executive Secretary Blair reported that SERS has received 5.5 months' worth of employer contributions, or slightly more than \$500 million from the General Revenue Fund (GRF). The system also receives approximately 1/3 of the employer contributions from Non-GRF payrolls, and those are made as non-GRF payrolls are processed. The Comptroller's Office's efforts to provide a more stable employer contribution to all of the retirement systems has made a difference, as the system is not drawing down large amounts of assets from the ISBI investment portfolio in order to pay benefits.

## REPORT OF ANY TRUSTEE

Chairperson Topinka asked if any other trustees would like to offer a report. Trustee Alison asked if there would be discussion of the impact the new law may have on the operations of the office. Executive Secretary Blair said it would be discussed in the Executive Session of the meeting. No other trustee offered a report.

## REPORT OF THE EXECUTIVE SECRETARY

Executive Secretary Blair reported the Illinois Public Pension Fund Association (IPPPFA) has established an advanced trustee training program. The IPPFA is having a two day course on February 12 and 13, 2014 in Chicago and that all the Board members may attend. Executive Secretary Blair promised to provide all the training details in an email.

In accordance with the Open Meetings Act, Executive Secretary Blair presented the Audit and Compliance Committee schedule for 2014. Starting in April the Committee will meet at 9:00 a.m., prior to the quarterly Board meetings.

## REPORT OF CHIEF INFORMATION SYSTEMS OFFICER (CISO)

Systems Modernization. Gerry Mitchell, CISO, informed the Board that work continues on the active member system. Also, the inactive member statements have been redesigned in a PDF format and the IT Division is working on the employer website, which will auto-populate the member's primary data when employers are filling out retirement forms. When the form is printed, it will include the barcode that is necessary to get it into the imaging system when it is received our office. This will be a much better process with more accuracy.

The System continues to make the infrastructure changes to allow for the installation of the Voice Over IP (VOIP) system and implementing the changes needed for Medicare Advantage. In addition, we are analyzing SB 1 to determine what system changes are required for pension reform. If possible, we will try to implement with the new technology as much as possible and try to avoid changing the old system as much as we can.

Business Continuity/Disaster Recovery. Mr. Mitchell informed the Board that the generator is scheduled to be operational this weekend. There will be a ten hour power outage over the weekend, which will require shutting down all computer systems completely.

Security. All anti-viruses and patches are up to date.

Accounting Information System (AIS). The System continues to review and tighten AIS security. We have been experimenting with the Service and Refunds Division and everything seems to be going pretty well.

Risk Assessment. The System continues to take corrective actions with issues that have been identified as risks. Next week bids will be going out for installing locking doors in the Accounting Division and the Files Section, the two areas with the most documents that contain Social Security numbers.

Staffing. IT continues to increase staffing levels. Mr. Mitchell informed the Board that two positions were offered and declined, while one applicant from DCFS has accepted a programming position. Trustee Morris asked if there were other candidates for the two positions

that were turned down. Mr. Mitchell responded that we are going to have to complete more interviews and create some internships as well.

Chairperson Topinka asked that assuming the pension legislation holds, how much of a burden is there going to be put on IT staff and is the system going to be able to handle it or will more people be needed. Mr. Mitchell answered that it will be handled. Chairperson Topinka asked if we think we will need more staff. Mr. Mitchell replied that it will come down to shifting resources from the new development, or to bring in some temporary help. Secretary Blair said we would utilize existing staff for the changes.

#### FIRST QUARTER FINANCIAL STATEMENTS

Alan Fowler, Accounting Division Manager, presented the financial statements for the first quarter of FY 14. Mr. Fowler noted that in comparison to the last quarter of FY 13, there was an increase in employer contributions of approximately \$27 million, due mainly to timely GRF contributions. He also noted a \$1.6 million decrease in resignation refunds due to fewer members terminating State employment when compared to the year earlier quarter.

He continued by noting that in comparing the first quarter of FY 13 to the first quarter of FY 14, there is an increase of approximately \$6.9 million in employee contributions, primarily the result of several payrolls coming through at the end of lapse period (end of August). In addition, the employer contribution rate increased in FY 14 to 40+%, compared to 37% in FY 13. Retirement annuities also increased since the previous fiscal year. That 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.

In regard to employer contributions, Mr. Fowler mentioned how much he has appreciated the cooperation of the Comptroller's Office staff, which has allowed SERS to pay benefits without drawing down assets from the ISBI portfolio. Mr. Fowler also noted that SERS is starting an Intergovernmental Transfer Program (ITP) with the Comptroller's Office. The GRF employer contributions that have been coming to the system by paper check (\$91 million per month) will now be deposited into the Trust electronically. Chairperson Topinka added that we can accomplish more when we work together.

Chairperson Topinka then asked if there were any questions. There being no more 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 B.

#### APPROVAL OF EXECUTIVE COMMITTEE MINUTES

The trustees had previously been furnished with copies of the October, November, and December 2013 Executive Committee minutes for review. There being no changes to these minutes, Trustee Silverthorn moved to approve. Trustee Rensing seconded the motion, which prevailed by the affirmative vote of all trustees.

#### PERSONNEL MATTERS AND LITIGATION - CLOSED SESSION

Trustee Ousley made a motion to go into Closed Session to discuss personnel matters and current litigation. Trustee Friedman seconded the motion. A roll call vote was taken by Recording Secretary Staley with all trustees present voting in the affirmative.

The Board returned to Open Session.

OLD BUSINESS

There was no old business to review.

NEW BUSINESS

Chairperson Topinka asked if there was any new business to be brought before the Board. Trustee Allison mentioned that he liked Chairperson Topinka's idea of the entire Board attending some future meetings at one location. Executive Secretary Blair informed the Board that he would look into possibilities.

Executive Secretary Blair then announced that Trustee Noser had resigned from the Board, effective January 13, 2014, as he is moving to Malaysia. Secretary Blair also informed that Board that he has been in contact with the Governor's Office regarding vacant and expired appointee positions. He reported that SERS has only two appointed Board members with current terms and those two positions will expire in July 2014.

Trustee Rensing asked about the process to replace the late Trustee Virginia Yates. Executive Secretary Blair said there is currently no formal process, but statutorily the Board has the ability to fill an elected trustee vacancy. He added that he thought we should adopt a process to fill these vacancies and offered to provide a process to review at the next meeting. Trustee Rensing asked to have something ready to adopt at the next meeting, as there has been a meeting that we failed to establish a quorum. Chairperson Topinka then asked Executive Secretary Blair if he could have a process to consider for the next meeting. He agreed that he would.

ADJOURNMENT

There being no further business to be brought before the Board, Trustee Ousley moved for adjournment at 12:10 p.m. The adjournment was seconded by Trustee Morris and all were in favor.

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Judy Baar Topinka, Chairperson

Date: \_\_\_\_\_

ATTEST:

\_\_\_\_\_  
Timothy Blair, Executive Secretary

Date: \_\_\_\_\_