



MINUTES

BOARD OF TRUSTEES

OF THE TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM

The regular quarterly meeting of the Board of Trustees was called to order at 9:30 a.m., January 25, 2018, by the Chair, State Treasurer Dale R. Folwell, CPA. The meeting was held in the Dogwood Conference Room of the Longleaf Building at 3200 Atlantic Avenue, Raleigh, NC 27604. The Chair reviewed recent press releases with the Board and introduced Patrick Kinlaw, the Retirement System's Director of Policy, Planning and Compliance. The Chair indicated there would be a public comment period for organizations and individuals to address the Board later in the agenda.

Members Present

The Board members present were: Treasurer Dale R. Folwell, Lentz Brewer, Barbara Gibson, Greg Grantham, Michael Mebane, Greg Patterson, Margaret Reader, Joshua Smith and Jeffrey Winstead.

Members Absent

The board members absent were Claire Miller (on behalf of Superintendent Mark Johnson) and Van Dowdy.

Guests Present

The guests attending were: Joseph Newsome with the Attorney General's Office; and Michael Ribble and David Driscoll with Conduent.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Thomas Causey, Joan Fontes, Jaclyn Goldsmith, Sam Hayes, Timeka Holden, Patrick Kinlaw, Fran Lawrence, Karah Manning, Mallori Morris-Bloom, Lisa Norris, Vicki Roberts, David Starling, Edgar Starnes, Christina Strickland and Sam Watts.

Ethics Awareness and Identification of Conflicts or Potential Conflicts of Interest

The Chair asked, pursuant to the ethics rules, about conflicts of interest of board members. No conflicts of interest were identified by the board members.

Approval of the Minutes from the October 26, 2017 Board Meeting

It was moved by Greg Patterson, seconded by Margaret Reader, and carried unanimously by the Board that the minutes from the Board meeting held on October 26, 2017, be approved.

Approval of the Minutes from the December 4, 2017 Special Board Meeting

It was moved by Jeffrey Winstead, seconded by Barbara Gibson, and carried unanimously by the Board that the minutes from the Board meeting held on December 4, 2017, be approved.

Retirement Systems Division Operations

The Chair recognized Thomas Causey, Deputy Director of Operations, for an update on the Division's Operations department. Mr. Causey reviewed the key takeaways from the operations report, noting that turnaround times for processing remain low and the team is working on completing many year-end required activities. Mr. Causey highlighted that retirement processing went from a 32 day processing period to a 9 day processing period over the last year. Mr. Causey also reported that the Division is reviewing the Disability programs and processes to ensure those members who are disabled receive timely service and the benefits promised to them.

The Chair recognized Deputy Director of Member Services, Vicki Roberts, for a presentation on the metrics for Member Services. Ms. Roberts reported on metrics on member correspondence noting volume was up 15 percent yet staff processed the correspondence 64 percent faster than last year. Ms. Roberts highlighted a 28 percent increase in member counseling sessions compared to the previous year. Next, Ms. Roberts reported on the metrics of the Call Center. She noted that the team is meeting their objectives by answering 87.5 percent of calls over the past year in less than a minute. Executive Director, Steve Toole complimented the work of the call center staff and leadership for responding to members needs so efficiently and effectively.

The Chair recognized the Director of Policy, Planning and Compliance, Patrick Kinlaw. Mr. Kinlaw reported on the Contribution-Based Benefit Cap (CBBC) Liabilities, noting the total CBBC liabilities invoiced as of January 10, 2018 were \$12.5 Million. Mr. Kinlaw also reported that \$11.2 Million in overpayments was collected over the past 13 months. Board member Michael Mebane asked what the reasons were for overpayments. Mr. Kinlaw responded that overpayments may occur for a number of reasons, including reasons related to the design of the benefit programs (such as the state's covering Social Security Disability payments while disabled members are awaiting Social Security approval), incorrect information provided by employers or members, or other administrative issues. He also reported that 3,331 retirement and disability plan members with overpayment balances were notified in December 2017 that their outstanding balance information had been provided to the NC Department of Revenue (NCDOR) for possible collection. The notification letter informed members that all or part of any NC income tax refund or lottery winnings may be withheld by NCDOR and forwarded to RSD to be applied to the overpayment balance.

Investment Advisory Committee (IAC) Update

The Chair recognized Greg Patterson for an update on the November 16, 2017 Investment Advisory Committee (IAC) Meeting. Mr. Patterson gave an update on the cost-efficiencies initiative, stating that cost savings have reached over \$67 million annually. Mr. Patterson reported that for the one (1) year ending September 30, 2017, the portfolio return was positive 10%. The portfolio has exceeded its actuarial assumed rate of return of 7.2% over the 5-year and 15-year historical periods, but it has not exceeded those returns over the 3-year, 10-year, or 20-year historical periods. The average return over the 20-year historical period is positive 6.5%. Mr. Patterson explained that the US large cap equity market segment is becoming increasingly efficient and the Public Equity team views passive management as the most prudent and cost efficient approach in this segment of the market. The Public Equity team estimated that in just a few years, the cumulative net savings generated from managing US large cap passive assets internally will be about \$2 million. Mr. Patterson discussed the real estate portion of the portfolio, pointing out that it is 8.5 percent of the portfolio. Mr. Patterson

concluded his remarks by updating the board on the results of the CEM Investment Benchmark Study.

Legislative Enactment Implementation Arrangement (LEIA)

The Chair introduced Steve Toole, Executive Director of the Retirement Systems Division (RSD), to speak on the "Legislative Enactment Implementation Arrangement" (LEIA) that was enacted by Session Law 2017-129. Mr. Toole outlined the purpose of LEIA is to provide for timely administrative implementation of legislative provisions regarding the retirement of or payment of retirement benefits to, public officers or public employees. In the event the General Assembly creates or modifies any provision for the retirement of, or payment of retirement benefits to, public officers or public employees that has a cost savings as measured by actuarial note, the Boards of Trustees may direct up to one one-hundredth of a percent (0.01%) out of the required employer contribution rate to fund the LEIA.

Mr. Toole explained that two LEIA accounts were set up on October 1, 2017; one under the management of the TSERS Board, and the second under the LGERS board. The boards have full discretionary authority to interpret, construe and implement the LEIA and to adopt any rules and regulations necessary or desirable to implement the provisions of LEIA. Annually on or before August 1, DST must report to the TSERS and LGERS Boards, the Joint Legislative commission on Government Operations and the Fiscal Research Division on the amounts and sources of funds collected by year and the amounts expended, the projects for which those funds were expended and the current status of the projects. This report must be submitted on or before August 1 of each year. Each Board of Trustees must also post this report on its public website.

Presentation on the Decennial Rules Final Report Pursuant to N.C.G.S. §150B-21.3A

The Chair recognized Christina Strickland, General Counsel for the Retirement Systems, for a presentation on the decennial rules final report. Ms. Strickland presented that as a result of the initial determination of rule classifications that were approved by the Board on October 26, 2017, the department initiated the open comment period for the time period of November 3, 2017 to January 2, 2018. Ms. Strickland reported that there were no public comments received. Ms. Strickland reminded the Board that each rule that is determined to be necessary with substantive public interest will remain in the North Carolina Administrative Code (NCAC) and rules determined to be unnecessary will be removed from the NCAC.

Ms. Strickland reported that once the final determination of the rule classifications have been approved, staff will submit the report and the classifications to the Rules Review Commission (RRC) for review and consultation with the Joint Legislative Administrative Procedures Oversight Committee for finalization. The RRC's review of the final report on retirement rules is currently scheduled for August 2018.

Michael Mebane made a motion to approve the final determination of the rule classifications, which was seconded by Greg Grantham and carried unanimously by the Board.

Increase in the Amount of Reemployment Earnings before Suspension of Retirement Allowance

Mr. Toole gave a presentation on the annual statutory increase in the compensation that may be earned by a re-employed beneficiary who is receiving either an early retirement benefit or a service retirement benefit, before suspension of a retirement allowance under G.S. §135-3(8)(c). Mr. Toole reported that the increase in the relevant measure of the Consumer Price Index (CPI) was 2.1 percent between December 2016 and December 2017.

It was moved by Jeffrey Winstead, seconded by Margaret Reader, and carried unanimously that the amounts which may be earned before suspension shall be increased effective January 1, 2018 equal to the increase in the CPI of 2.1 percent, as published by the United States Department of Labor, and the 50 percent of compensation amount should be increased by the same percentage increase in the CPI effective January 1, 2018. Under this motion, the 50 percent of compensation amounts would increase by 2.1 percent and the adjusted amount would increase from \$32,260 to \$32,940, effective January 1, 2018.

Actuarially Determined Employer Contribution (ADEC) Projections for State System

The Chair recognized Michael Ribble and David Driscoll, from Conduent, to present on the actuarially-determined employer contribution (ADEC) for the State System.

Mr. Ribble and Mr. Driscoll presented a baseline deterministic projection that was based on the December 31, 2016 valuation results and assumed an interest rate of 7.2 percent for all years, investment return of 13.25 percent for calendar year 2017, and an investment return of 7.2 percent on market value of assets for all future years. Mr. Ribble reported that the employer contribution rates will increase under the Employer Contribution Rate Stabilization Policy (ECRSP) through fiscal year 2022. Mr. Ribble reviewed the future funded ratio due to the calculations of the baseline projection.

Mr. Ribble and Mr. Driscoll also presented two alternative deterministic projections for the employer contribution rate and funded status. Both alternatives were based on the same assumptions as the baseline projection, except that future valuation interest rates were assumed to be 7.15 percent for the December 31, 2017 valuation with an annual decline of .05 percent thereafter until reaching an ultimate rate of 6.0 percent for the December 31, 2040 and later valuations. Alternative 1 (A1) assumed future investment returns were to be equal to the discount rate from the valuation at the end of the prior year. Alternative 2 (A2) assumed all future investment returns were to be equal to 6.0 percent per year. The actuaries presented the results of the two projections, stating that A2 assumes a lower asset return when compared to A1 and as a result, the unfunded accrued liability and normal cost will be higher resulting in higher projected contributions and a lower projected funded ratio with a constant investment return of 6.0 percent.

The actuaries also presented to the Boards another set of alternative deterministic projections. Both alternatives (A3 and A4) were based on the same assumptions as the baseline projection, except the projections assume that the Board elects in 2018 to use a discount rate of 7.0 percent for the December 31, 2017 valuation and that discount rate remains in place through the December 31, 2020 valuation. These projections also assume that the Board elects in 2022 to use a discount rate of 6.75 percent for the December 31, 2021 valuation remaining in place through the December 31, 2025. Continuing with this pattern, it assumes the Board votes in 2027 to use a discount rate of 6.5 percent for the December 31, 2026 valuation, votes in 2032 to use a discount rate of 6.25 percent for the December 31, 2031 valuation, and votes in 2037 to use a discount rate of 6.0 percent for the December 31, 2036 and later valuations. Future investment returns were assumed to be equal to the discount rate from the valuation at the end of the prior year under this projection. The ADEC for each year was based on a phase-in of the newly adopted discount rate and assumes the ADEC is paid each year and the phase-in period is assumed to be four years of the change to 7.0 percent discount rate and five years of all other assumed discount rate changes. Alternative 4 (A4) deviated from this alternate projection with assumed investment returns were to be equal to 6.0 percent each year. The actuaries presented the results of the two projections, stating that A4 assumes a lower

asset return when compared to A3 and as a result, the unfunded accrued liability and normal cost will be higher resulting in higher projected contributions and a lower projected funded ratio with a constant investment return of 6.0 percent.

In these scenarios, for GASB purposes the discount rate would drop to the ultimate rate the board adopts (for example, the GASB discount rate would be 7.00% for the December 31, 2017, valuations). Similarly, the ultimate rate adopted by the Board (7.00% as of the December 31, 2017, valuations) would be used for plan administration and for purposes of measuring the funded status. However, the impact on employer contribution rates would be phased in over the periods described above. This is sometimes referred to as "direct-rate smoothing."

Mr. Ribble and Mr. Driscoll noted that all of the projections were intended to illustrate the sensitivity of various outcomes to the actual or assumed investment returns, and that the use of sensitivity projections should not be interpreted as an assumption recommendation.

Presentations on the 2018 Fiscal Year Alternatives for the General Assembly

Mr. Toole presented the 2019 fiscal year policy options and recommendations for the General Assembly for the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Legislative Retirement System, the Disability Income Plan of North Carolina, and the National Guard Pension Fund.

Mr. Toole presented the fiscal policy options for the Teachers' and State Employees' Retirement System. He stated that according to the most recent actuarial valuation report, the Actuarially Determined Employer Contribution (ADEC) rate for fiscal year ending 2019 is 11.98 percent, which is greater than the currently appropriated employer contribution rate in the state budget of 11.87 percent for fiscal year ending 2019. Mr. Toole reviewed the Employer Contribution Rate Stabilization Policy (ECRSP) that was adopted by the Board of Trustees on January 21, 2016. He stated that, based on the policy, contributions will be at least 0.35 percent of payroll greater than the appropriated contribution rate from the prior fiscal year. Additionally, the contributions cannot be less than the ADEC rate (11.98 percent), and cannot be greater than a contribution rate determined using the same assumptions used to calculate the ADEC but with a discount rate equal to the long-term Treasury bond yield (approximately 64.12 percent).

Mr. Toole reported that the appropriated employer contribution rate for the fiscal year ending 2019 is 10.78 percent. With respect to fiscal year ending 2019, the ECRSP adds 0.35 percent to the prior year's appropriated employer contribution rate, yielding a rate of 11.13 percent, which is lower than the actuarially required ADEC of 11.98% and not permissible. Therefore, for fiscal year 2019, staff recommended that the Board request an increase to the current appropriation to fund the employer contribution rate is 11.98 percent of payroll. This is an estimated increase to the state budget of \$121.9 million compared to the currently appropriated rate of 11.87 percent for fiscal year ending in 2019.

Mr. Toole shared that a calendar year 2017 investment return of 20.7 percent was needed on the portfolio to offset previous investment losses that were being carried forward from previous years and produce investment gains sufficient to recommend to the North Carolina General Assembly a 1 percent cost-of-living-adjustment (COLA) on retiree benefits. The projected return of positive 13.25% for calendar year 2017, while strong, is not sufficient to offset the investment losses from previous years, and therefore, no cost-of-living-adjustment (COLA) could be funded by actuarial gains.

Mr. Toole presented the fiscal policy options for the Consolidated Judicial Retirement System, stating that the most recent valuation report showed that the recommended ADEC of 32.35 percent for the fiscal year ending in 2019 is greater than the state budget of 31.05 percent for the fiscal year ending in 2018. Therefore, staff recommended that the Board request recommends an increase to the current appropriation to fund the ADEC, an increase from the General Fund of \$976,001.

Mr. Toole presented the fiscal policy options for the Legislative Retirement System, stating that the most recent valuation report showed that the recommended ADEC of 21.74 percent for the fiscal year ending in 2019 exceeded the state budget of 19.04 percent for the fiscal year ending in 2018. Therefore, staff recommended that the Board recommend an increase to the current appropriation to fund the ADEC, an estimated increase from the General Fund of \$97,740.

Mr. Toole presented the fiscal policy options for the Disability Income Plan, stating that the most recent valuation report showed that the recommended Annual Required Contribution is 0.13 percent of state payroll for the fiscal year ending in 2019. Therefore, staff recommended that the Board request the North Carolina General Assembly lower the Employer Contribution Rate from 0.14 percent of payroll to 0.13 percent of payroll, an estimated reduction in the appropriation of \$1.7 million.

Lastly, Toole presented the fiscal policy options for the North Carolina National Guard, stating that most recent valuation report showed that the ADEC dollar amount of \$9,071,933 for fiscal year ending in 2019 exceeded the state budget of \$8,923,153 for the fiscal year ending in 2018. Staff recommended an increase to the appropriation to fund the ADEC plus an additional increase of \$2 million to allow for a more rapid payment of the plan's unfunded liability. In total, the staff recommended that the Board request an appropriation of \$11,071,933 for fiscal year ending in 2019, an increase of \$2,148,780 from the appropriation for fiscal year ending in 2018.

Public Comment Period

The Chair recognized the following organizations' representatives for presentations on retirement benefit proposals for the Board to consider:

Pam Deardorff and Lacy Presnell, on behalf of North Carolina Retired School Personnel (NCRSP), shared their support for the employer contribution rate increase to 11.98 percent and is hopeful for opportunities in future system gains to fund COLAs for retirees.

Ardis Watkins, on behalf of the State Employees' Association of North Carolina (SEANC), recognized the importance for lowering investment fees and asked the board of trustees to work diligently in support of a COLA for retirees.

Richard Rogers, on behalf of the North Carolina Retired Governmental Employees' Association (NCRGEA), shared his appreciation for continuing to examine the rate of return assumption, supports full funding of the employer contribution rates and reminds the board of trustees on the importance of COLA's for our retirees.

Rose Williams, on behalf of the North Carolina League of Municipalities, shared the League's appreciation of the Employer Contribution Rate Stabilization Policy.

Recommendations to the North Carolina General Assembly on Actuarially Determined Employer Contribution (ADEC) Rates for Fiscal Year Ending 2019

After hearing public comments, the Board made the following fiscal recommendations to the North Carolina General Assembly:

It was moved by Mike Mebane, seconded by Jeff Winstead, and carried unanimously to recommend to the North Carolina General Assembly to increase the employer contribution rate to 11.98 percent for the Teachers' and State Employees' Retirement System. The additional appropriation needed from the General Fund would be \$121.9 million.

It was moved by Mike Mebane, seconded by Greg Patterson, and carried unanimously to recommend to the North Carolina General Assembly to increase the employer contribution rate to 21.74 percent for the Legislative Retirement System. The additional appropriation needed from the General Fund would be \$97,740.

It was moved by Greg Patterson, seconded by Jeff Winstead, and carried unanimously to recommend to the North Carolina General Assembly to increase the employer contribution rate to 32.35 percent for the Consolidated Judicial Retirement System. The additional appropriation needed from the General Fund would be \$976,001.

It was moved by Mike Mebane, seconded by Margaret Reader, and carried unanimously to recommend to the North Carolina General Assembly to lower the employer contribution rate offrom 0.14 to 0.13 percent for the Disability Income Plan for North Carolina. This decrease creates a cost savings of \$1.7 million without negatively impacting the funding of the plan.

It was moved by Greg Patterson, seconded by Joshua Smith and carried unanimously to recommend to the General Assembly to increase the current appropriations to 411,071,933 (thereby increasing the current ADEC by \$2,184,780 million above the ADEC) for the North Carolina National Guard. The increase would provide for an accelerated payment schedule that would pay off the unfunded liability in about 8.5 years, instead of the current 12-year amortization schedule.

Designation of Board of Trustees' Actuary

Mr. Toole and the evaluation committee gave a presentation on the final recommendation to the Board on the selection of the actuary to be the technical advisor to the Board of Trustees on matters regarding the operation of funds and other duties as required by the Board. This call for action was a result of the Department's request for proposals for the actuarial services contract due to expiration of the current actuarial contract and renewals between the Department and Conduent HR Consulting, Inc. He reported that staff submitted recommendations to the evaluation committee on finalist candidates based on thorough examination of proposals. Finalist presentations took place on October 27, 2017 and the evaluation committee recommended award to Cavanaugh Macdonald Consulting based on best value to the State and ability to meet the State of North Carolina terms and conditions. He stated that the Department of Administration Purchasing and Contract approved the recommendation to enter into contract with Cavanaugh Macdonald with a contract limit not exceed of \$2,996,490 for the three-year period and includes two optional one-year renewals at the option of the department.

Mr. Toole stated that the staff committee was recently made aware of litigation filed against Cavanaugh Macdonald Consulting regarding their work with the Kentucky Retirement System (KRS). Through evaluation of publicly available documents, the Department recommended incorporating enhanced disclosure provisions in actuarial reporting into the contract, which staff would incorporate during contract negotiations.

It was moved by Greg Patterson, seconded by Jeff Winstead, and unanimously carried by the Board to approve the designation of Cavanaugh Macdonald Consulting to be the technical advisor to the Board of Trustees.

Board of Trustees Comments

Prior to entering into Closed Session, the Chair asked the Board if there were any comments prior to adjournment of the meeting. The Board had no comments.

Closed Session Pursuant to N.C.G.S. §143-318.11(a)(3)

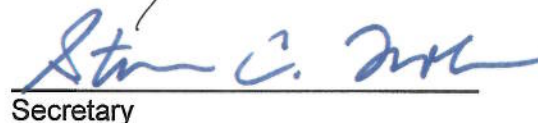
The Chair asked for a motion to enter into closed session pursuant to N.C.G.S. §143-318.11(a)(3) to consult with legal counsel regarding pending litigation involving Johnston, Wilkes, Union and Cabarrus Counties Boards of Education. It was moved by Jeff Winstead, seconded by Greg Grantham, and carried unanimously by the Board to enter into closed session. All attendees, other than the Board members and applicable staff, were instructed to exit the conference room.

Greg Patterson made a motion to reopen the meeting, which was seconded by Greg Grantham and carried unanimously by the Board.

State System Adjournment

There being no further business before the Board, Greg Patterson moved to adjourn, which was seconded by Lentz Brewer, and the meeting was adjourned unanimously at 12:27 p.m.


Chair


Secretary