MINUTES

BOARD OF TRUSTEES

OF THE LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM

The regular quarterly meeting of the Board of Trustees was called to order at 9:33 A.M., January 21, 2016, by the Chair, State Treasurer, Janet Cowell. The meeting was held in the Dogwood Conference Room of the Longleaf Building at 3200 Atlantic Avenue, Raleigh, NC 27604. The Chair notified attendees that there would be public comment period for organizations and individuals to address the Boards. The Chair gave an update on board vacancies and pending appointments.

Members Present

The Board members present were: Treasurer Janet Cowell, John Anarella, Mike Bradley, Lentz Brewer (via telephone), Randy Byrd, Kay Cashion, Kevin Gordon (via telephone), LouAnn Phillips on behalf of Superintendent June Atkinson, Sally Sandy, Carson Smith, and Grady Smith.

Members Absent

No Board members were absent.

Guests Present

The guests attending were: Robert Curran, from the Attorney General's Office; and Larry Langer and Michael Ribble, from Buck Consultants.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Bryan Allard, Nick Byrne, Thomas Causey, Jaclyn Goldsmith, Schorr Johnson, Fran Lawrence, Vicki Roberts, Marni Schribman, Kevin SigRist, Anthony Solari, Edgar Starnes, Christina Strickland, Blake Thomas, and Sam Watts.

Conflicts of Interest

The Chair asked, pursuant to the ethics rules, about conflicts of interest of Board Members. There were no ethics conflicts identified by the Board members.

Approval of the Minutes from the October 22, 2015 Meeting

It was moved by John Anarella, seconded by Carson Smith, and carried that the minutes of the Board meeting held on October 22, 2015, be approved.

Approval of the Minutes from the December 7, 2015 Special Meeting

It was moved by John Anarella, seconded by Carson Smith, and carried that the minutes of the Board meeting held on December 7, 2015, be approved.

Increase in Re-employment Earnings Before Suspension of Retirement Allowance

The Chair recognized Steve Toole, Retirement Systems Division Director, for 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. §128-24(5c). Mr. Toole announced the Consumer Price Index (CPI) was released on January 20, 2016, and recorded a 0.7 percent increase over the last 12 months. Following the presentation, it was moved by Carson Smith, seconded by Greg Grantham and carried unanimously that the amounts which may be earned before suspension shall be increased effective January 1, 2016, equal to the increase in the CPI as published by the U.S. Department of Labor. Therefore, the maximum amount a re-employed retiree can earn without affecting his/her monthly retirement allowance is increased by the greater of 0.7 percent of the 50 percent compensation amounts or an adjusted amount of $31,600, both effective January 1, 2016.

Presentation on the Projected North Carolina Retirement System Investment Returns

The Chair recognized Kevin SigRist, Chief Investment Officer, for a presentation on the projected investment return assumption. Mr. SigRist summarized the January 8, 2016 Investment Advisory Committee (IAC) Meeting's discussion of the investment return assumption. There was IAC consensus that achieving the 7.25 percent return over the next 10 years was unlikely, and revising the asset allocation policy in order to raise the expected return materially toward 7.25 percent over the next ten years would incur more risk than deemed prudent. Some IAC members were comfortable that achieving a 7.25 percent return over a 30-year period with existing asset allocation policy was reasonable, although there was acknowledgment that investment returns would have to be quite strong over the last decade of the 30-year period to meet the 7.25 percent expectation. Other IAC members did not believe that the 7.25 percent expectation would be satisfied by likely returns from the investment program, even over a 30-year period. Skepticism was particularly strong about a 7.25 percent expectation if it was dependent on materially exceeding broad investment market benchmarks through active management. Some IAC members felt that it could be helpful to fund the NCRS in the short- or intermediate-term consistent with a lower rate of return expectation, regardless of the formal discount rate assumption. There was IAC consensus that IMD should initiate an asset liability study that could utilize updated and alternative asset allocation assumptions. IAC members expressed an interest in examining whether policy changes are warranted given the low returns expected over the 10-year period. The project would involve running updated scenarios through actuarial modeling to see the impact on funded status, contribution rates, and contribution rate volatility over time. Several members of the Board posed questions to Mr. SigRist, and Board members discussed whether lowering the 7.25 percent investment return assumption would be prudent. Mr. Mebane expressed great concern over the possibility that in the 10 and 20 year horizons, the state may be facing a headwind to meet the assumed rate of return. His view was that the downside of failing to meet the assumed rate of return for a protracted period could mean that the state would be, in effect, taking on a large debt to cover pension underfunding

Public Comment

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

Rose Vaughn Williams, N.C. League of Municipalities

Pam Deardorff, N.C. Retired School Personnel Association

Richard Rogers, N.C. Retired Government Employees' Association

Presentation on Annual Required Contribution (ARC) Projections for the Local System

The Chair recognized Larry Langer and Michael Ribble, from Buck Consultants, for a presentation on the Annual Required Contribution projections for the Local Governmental Employees' Retirement System (LGERS). The projection is based on: (1) December 31, 2014, valuation results of LGERS, except that proposed economic and demographic assumptions have been reflected based on the experience study presented in October 2015 as modified to reflect the latest mortality projection scale (MP-2015); (2) valuation interest rate and assumed asset return of 7.25 percent for all years; (3) no cost-of-living adjustments granted; (4) assumes future rate of pay increases based on long-term valuation; and (5) assumes active headcount will remain level in future years. For comparison purposes, they also included the "Baseline Projection" for LGERS presented in October 2015 that was based on the December 31, 2014 valuation, results. The projection, which did not reflect the proposed experience study changes, was based on the valuation interest rate and the assumed rate of return of 7.25 percent for all years. Mr. Langer stated that the proposed experience study changes will result in a decrease in contributions for general employees compared to just the valuation projection. He also explained that the proposed experience study changes decrease the funded status initially, but recovery to 100 percent funding is still projected to occur within four years under current assumptions. In addition to reflecting on the demographic and economic assumptions from the proposed experience study, Buck Consultants performed an alternative projection assuming a lower rate of return for calendar year 2015. For this projection, the assumed rate of return is 0.23 percent for 2015, and 7.25 percent for all future years. Mr. Langer explained that asset returns less than 7.25 percent create an actuarial loss which is phased in over five years using an asset smoothing method. This creates a pattern of steadily increasing contribution requirements relative to baseline projections. In regards to the projected funded ratio, the asset loss created by return of 0.23 percent in 2015 is recognized over the next five years under the current asset smoothing method.

Presentation on the Stabilization of Employer Contribution Rates for the Local System

The Chair recognized Larry Langer and Michael Ribble, from Buck Consultants, for a presentation on the LGERS Employer Contribution Rate Stabilization Policy. Mr. Langer stated that the proposed new Employer Contribution Rate Stabilization Policy establishes a fixed contribution rate schedule for the next several years. Under the proposed policy, contributions would be set at 7.25 percent of payroll for the fiscal year ending 2017, and will increase each fiscal year by 0.25 percent per year for five years, with the following additional adjustments, if applicable: (1) if the underlying ARC for a given year is 50 percent higher than the scheduled employer contribution rate for that fiscal year, then the scheduled employer contribution rate for the current and future fiscal years increases 0.50 percent; (2) if the underlying ARC for a given year is 50 percent lower that the scheduled employer contribution rate for the fiscal year, then the scheduled employer contribution rate for the current and future fiscal years decreases 0.50 percent; (3) Law Enforcement Officer rates will be 0.75 percent higher than General Employee rates; and (4) if the General Assembly grants any additional cost-of-living-adjustment (COLA) beyond the amount of COLA allowed to be granted by the Board, increases the multiplier for active employees, or changes the benefit structure in a way that has a cost to the system, then the schedule of contributions for the current and future fiscal years will be increased by the cost of the additional COLA, increased multiplier or other benefit enhancement. The cost of any allowable COLA granted by the Board under the authority allowed by statute will not impact the scheduled contribution rates.

Presentation on the Court Cost Offset for Law Enforcement Officers

The Chair recognized Steve Toole for a presentation on the Court Cost Offset for Law Enforcement Officers. Mr. Toole stated that the Department of State Treasurer is required to use certain funds derived from court costs to offset the employer contribution rates paid for law enforcement officers participating in LGERS. The Department reviews receipts of these funds and updates the offset periodically. The offset was adjusted in January 2014 beginning with fiscal year 2015 with the intention of leaving it stable through fiscal year 2017. If approved by the Board of Trustees, then the LGERS Employer Contribution Rate Stabilization Policy will provide that the Law Enforcement Officer rate will exceed the General Employer rate by 0.75 percent each year. Under the policy, any COLA or rate adjustment greater than the COLAs that may be granted by the Board for General Employees should be similarly reflected in the Law Enforcement Officer rate. The net contribution rate would be 8 percent. Mr. Toole then presented a scenario in which the Board does not adopt the LGERS Employer Contribution Rate Stabilization Policy. The December 31, 2014, valuation of LGERS, adjusted to reflect the proposed assumptions form the experience study and the latest mortality projection scale, indicates that the ARC is 7.09 percent of payroll for Law Enforcement Officers. This represents a decrease of 0.06 percent from the current year contribution rate. The court offset for the 2017 Fiscal Year is -0.14 percent and the death benefit rate for Law Enforcement Officers, which is a mandatory benefit, is 0.14 percent. Thus, the minimum net payable employer rate for Law Enforcement Officers is 7.09 percent. Any COLA or rate adjustment greater than the minimum rate decided by the Board for General Employees should be similarly reflected in the Law Enforcement Officer rate.

Adoption of the Proposed Assumptions as set in December 31, 2014, Local System

The Chair recognized Larry Langer and Michael Ribble for a presentation about the proposed assumptions. They stated that on October 22, 2015, they had presented the “Investigation of Demographic and Economic Experience Five Year Period from January 1, 2010-December 31, 2014” for LGERS and the Firefighters’ and Rescue Squad Workers’ Pension Fund (FRSWPF). The experience review resulted in changes to the demographic assumptions, economic assumptions and the funding methods. Subsequent to the October meeting, the proposed demographic assumptions were adjusted to reflect the mortality projection scale MP-2015, released by the Society of Actuaries on October 8, 2015. Buck Consultants believes that the revised mortality projection scale is reasonable to adopt and that the combined package of revised assumptions remains appropriate for use prospectively. They reviewed the key takeaways from the experience review of LGERS and FRSWPF that were originally presented at the October 22, 2015, meeting.

It was moved by Sally Sandy and seconded by Kay Cashion that the proposed assumptions be adopted by the Board. The original motion was then amended by John Anarella, and seconded by Mike Bradley to include the adoption of the LGERS Employer Contribution Rate Stabilization Policy by the

Board. The amended motion was carried unanimously by the Board to adopt the proposed assumptions and the LGERS Employer Contribution Rate Stabilization Policy.

Presentations on 2016 Fiscal Year Alternatives

The Chair recognized Steve Toole for a presentation on the 2016 Fiscal Year Alternatives. Mr. Toole first presented the 2016 Fiscal Alternatives for LGERS. Based on assumptions adopted in 2010, the most recent valuation report shows that the new ARC of 6.39 percent is lower than the current employer contribution rate, which is 6.67 percent. However, subsequent to the valuation report, an experience study has been performed. Based on the proposed assumptions from the experience study adjusted to reflect the latest mortality projection scale (MP-2105), the ARC for the fiscal year ending 2017 would be 5.47 percent for General Employees, and 7.09 percent for Law Enforcement Officers, which is less than the current employer contribution rate of 6.67 percent for General Employees and 7.15 percent for Law Enforcement Officers for fiscal year ending 2016. Therefore, the Board can decrease the employer rate by 1.20 percent of payroll for General Employees and 0.06 of payroll for Law Enforcement Officers, or $56.7 million to meet this (the?) ARC for the fiscal year ending 2017. However, the Board adopted the five-year Employer Contribution Rate Stabilization Policy. Under this policy, the contributions for General Employees will be set at 7.25 percent of payroll for the fiscal year ending 2017, and will increase each fiscal year for five years, with adjustments if applicable under the policy. Mr. Toole presented three policy options for the Board's consideration: 1) to increase the employer contribution rate to fund the ARC based on approved Employer Contribution Rate Stabilization Policy; 2) to increase the employer contribution rate to fund the ARC based on approved Employer Contribution Rate Stabilization Policy and grant a 0.105 percent COLA; or 3) to recommend an increase to employer contribution rate to the ARC based on approved Employer Contribution Rate Stabilization Policy, increase the multiplier for active employees, and include a corresponding increase to all beneficiaries. It was moved by John Anarella, seconded by Mike Bradley, and carried that the Board to select option 2 to increase the employer contribution rate of 6.67 percent for General Employees to 7.25 percent and the employer contribution rate of 7.15 percent for Law Enforcement Officers to 8 percent in accordance with the Employer Contribution Policy and concurrently grant a 0.105 percent COLA. Given investment gains in 2014, this is the maximum amount of COLA that the Board may grant under the authority allowed in the statute. The additional cost to employers for fiscal year ending 2017 would be $36 million.

Mr. Toole then presented 2016 Fiscal Year alternatives for FRSWPF. Based on assumptions adopted in 2010 and slightly modified in 2015, the most recent valuation shows that the new ARC of $12,830,706 is lower than the appropriation for the fiscal year ending 2016 which is $13,550,000. However, subsequent to the valuation report, an experience study has been performed. Based on the proposed assumptions from the experience study adjusted to reflect the latest mortality projection scale (MP-2105), the ARC for the fiscal year ending 2017 would be $17,602,208, which is greater than the current state budget of $13,550,000 for the fiscal year ending 2016. Therefore, the allocated state budget will need to be increased by $4,052,208 to meet the ARC using the proposed assumptions from the experience study, as modified for MP-2015. Further adjustments to this estimated increase may be warranted when the data audit of this plan is complete. Mr. Toole presented two policy options for the Board's consideration: 1) to recommend an increase to the current employer contribution rate to fund the ARC based on approved experience study assumptions; or 2) to recommend an increase to employer contribution to fund the ARC based on approved experience study assumptions and a $10 increase to monthly benefit. It was moved by Mike Bradley, seconded by Grady Smith, and carried that the Board to select option 1 to recommend that the General Assembly increase the employer contribution to $17,602,208.

Presentation on Results of the Experience Review

The Chair recognized Larry Langer and Michael Ribble for a presentation on the results of the investigation of demographic and economic experience for the Register of Deeds Supplemental Pension Fund and the death benefit plans. They reviewed the valuation process. Over the short-term period, contributions are determined by the actuarial valuation based upon estimated investment returns, benefits, and expenses using assumptions and methods recommended by the actuary and adopted by the Board. Over the long-term period, contributions are adjusted to reflect actual investment returns, benefits, and expenses. Mr. Langer presented the results of the experience review for the Register of Deeds Supplemental Pension Fund. The mortality assumption was the source of the largest increase in costs, outside of the change in investment return. The current investment return assumption of 5.75 percent is no longer reasonable under current market conditions. They propose changing the investment return assumption to 3.75 percent. Overall, the net impact on liabilities was an increase.

They presented the results of the experience review for the death benefit plans. The mortality assumption was the source of the largest decrease in costs. They stated that the current investment return assumption of 5.75 percent is no longer reasonable under current market conditions, and are therefore proposing to change the investment return assumption to 3.75 percent. The net impact was an increase in surplus for the LGERS death plans, a decrease in the surplus for the Separate Insurance Benefits Plan for law enforcement officers, and an increase in the unfunded status for the Contributory Death Benefit Plan. It was moved by Kay Cashion, seconded by John Anarella, and carried by the Board unanimously that the experience reviews for the Register of Deeds Supplemental Pension Fund and the death plans be accepted.

Retirement Systems Division Operations Update

The Chair recognized Thomas Causey, Deputy Director of Operations, and Vicki Roberts, Deputy Director of Member Services, for an update on benefit administration operations. Mr. Causey gave a report on the metrics for retirement processing, service purchases, estimate requests, disability applications, death notification processing, refund requests, and payroll processing. He stated that RSD is meeting its goals for processing service retirements. The turnaround time is higher than expected, but should drop over the next few months. The disability turnaround time continues to improve with hiring of new supervisor. He stated that this is a busy time of year for deaths, as more are reported during the holidays. Refunds are expected to increase with implementation of Required Minimum Distributions statutory provisions. There have been 28 retirees whose retirement benefit has exceeded the contribution-based benefit cap (pursuant to the new anti-pension spiking law), with a cost exceeding $2 million dollars through January.

Ms. Roberts gave a report on the Member Services metrics. The Imaging Group is processing all documents coming into RSD in less than a day. The Learning and Development Group is training new employees, particularly for the call center as they have held five back-to-back, 6-week training classes, since July. The turnaround time is higher than expected for the Educational Retirement Group (ERG), but should improve once the two vacant ERG positions are filled. The Retirement Readiness Education presentations, meetings and webinars are being held and ERG is on track to hit the goal of 170 meetings for the year. She stated that as of the Board meeting date through November 2015, 88 meetings have been held, with 5,773 attendees. The Call Center is currently operating with 21 Reps, out of the 32 needed, so the service level goal has not been met recently. However, they are actively working on filling vacancies, as well as looking into implementing call recording and a workforce management tool. She stated that these improvements will allow them to operate more effectively and efficiently.

Presentation on the 2015 Comprehensive Annual Financial Report

The Chair recognized Fran Lawrence, Chief Financial Officer, for a presentation on the 2015 Comprehensive Annual Financial Report (CAFR). The North Carolina CAFR is a set of audited annual, governmental financial statements that complies with the governmental accounting standards, which includes financial information for all fund types of the departments, agencies, boards, commissions, and authorities governed and legally controlled by the state. Ms. Lawrence presented portions of the state CAFR to the board that relate to retirement. She noted that this is the first year in which Governmental Accounting Standards Board (GASB) statements 67 and 68 are both fully implemented and the results are included in the CAFR. There have been technical amendments and changes to GASB 67 and 68 that have been reviewed by the State and implemented as appropriate. She further noted that new GASB standards may impact pension-related information that will be reported in the CAFR. Lastly, Ms. Lawrence reported that the State is in the process of implementing the requirements of GASB 74 and 75 for the State's Other Post-employment Benefits

State System Adjournment

There being no further business before the Board, the meeting was adjourned at 1:26 p.m. without objection.

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CHAIR

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SECRETARY