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 9:33 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, Lentz Brewer (via telephone), Jack Brooks, Van Dowdy, Greg Grantham, Alberta Hall, Michael Jacobs, Michael Mebane, and LouAnn Phillips on behalf of Superintendent June Atkinson.

Members Absent

Board members absent was: William Grey.

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 LouAnn Phillips, seconded by John Anarella, 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 LouAnn Phillips, seconded by John Anarella, 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. §135-3(8)(c). 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 7.25percent 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, though 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

Report from the Committee on Entry and Exit Procedures for Charter Schools

The Chair recognized Michael Mebane for an update on the Committee on Entry and Exit Procedures for Charter Schools. Session Law 2015-168 requires changes to the process by which charter schools are admitted to the Retirement System, and requires that the TSERS Board of Trustees vote to grant (or deny) new or existing charter schools "full affiliation" with the TSERS based on a financial and actuarial review. The first committee meeting was convened on November 17, 2015, to evaluate the information that is available from the Department of Public Instruction (DPI) and the Retirement Systems Division (RSD) to aid the Board in carrying out its new responsibilities related to the charter school admission process in the TSERS. Based on the discussion at the meeting, the Committee members determined that DPI and RSD have extensive operational and financial information available to the Board members that would be sufficient to conduct a comprehensive financial review and make an informed decision regarding charter school entry. The Committee will continue its work and will report to the Board in subsequent meetings.

Presentation on Annual Required Contribution (ARC) Projections for State System

The Chair recognized Larry Langer and Michael Ribble, from Buck Consultants, for a presentation on the Annual Required Contribution projections for the Teachers' and State Employees' Retirement System (TSERS). The projection is based on: (1) December 31, 2014, valuation results of TSERS, 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 7.25percent 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 TSERS presented in October 2015 based on the December 31, 2014, valuation results. The projection, which does not reflect the proposed experience study changes, was based on the valuation interest rate and assumed rate of return is assumed to be 7.25 percent for all years. They stated that reflecting the proposed experience study changes results in an initial increase in contributions. However, after the 12 year amortization is complete, contribution rates are actually lower under the proposed experience study changes. Mr. Langer presented the projected funded ratio for the system, stating that the proposed experience study changes decrease the funded status initially, but recovery to 100 percent is still projected to occur within 3 years of projected full funding under the 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 0.23percent for 2015, and 7.25percent for all future years. Asset returns less than 7.25percent 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. The asset loss created by return of 0.23percent 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 State System

The Chair recognized Larry Langer and Michael Ribble, from Buck Consultants, for a presentation on the stabilization of employer contribution rates for TSERS. Mr. Langer stated that the ARC projections show the impact of assumptions recommended as the result of the experience study as well as showing the impact of 2015 asset return of 0.23 percent. The projections assumed contributions are made to TSERS in the amount determined by the ARC. To promote security of benefits and to stabilize the employer contribution rate, a policy of making contributions greater than the ARC could be established, which they refer to as an "Employer Contribution Rate Stabilization Policy." This policy can be used to increase contributions in a period when investment returns are less likely to achieve 7.25 percent. They stated that the projections that follow in the presentation demonstrate one example of an "Employer Contribution Rate Stabilization Policy" (Policy). The example assumes contributions to the System equal to the maximum of the current year's ARC and the prior year's appropriated contribution rate under the Policy increased by 35 basis points (for FYE 2017, assumed to be the FYE 2016 appropriation of 9.15 percent plus 35 basis points); but not greater than the contribution rate determined using a discount rate indexed by the 30-year Treasury Rate as of the actuarial valuation date. The 30-year Treasury Rate is 2.75 percent as of December 31, 2014, and the maximum contribution rate based on 30-year Treasury Rate is estimated to be 53.48 percent as of December 31, 2014. Mr. Langer presented four rate of return scenarios for 2016, projecting a rate of return of -5.0, 0, 7.25, and 14.5 percent. The Policy projections rely on the December 31, 2014, valuation results of TSERS (with the exception of the proposed economic and demographic assumptions that have been included based on the experience study presented in October 2015 to reflect the latest mortality projection scale (MP-2015)); no cost-of-living adjustments; assumes future pay increases based on long-term valuation; assumes active headcount will remain level in future years; assumed rate of return for 2015 of 0.23percent; assumes rate of return for 2017 and beyond equal to 7.25percent; and, assumes that the Policy is in place for FYE 2017 to FYE 2022 which will then revert to funding the ARC for FYE 2023 and beyond. Mr. Langer stated that only in the scenario with 14.5percent rate of return in 2016 results in contributions under the Policy greater than the ARC. In other rate of return scenarios, asset losses occur in excess of 35 basis points each year, meaning each year funding is based on the ARC.

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

The Chair recognized Larry Langer and Michael Ribble for a presentation about the proposed assumptions for the State Systems. Mr. Langer stated that on October 22, 2015, Buck Consultants had presented the "Investigation of Demographic and Economic Experience Five Year Period from January 1, 2010-December 31, 2014" for TSERS, Consolidated Judicial Retirement System (CJRS), Legislative Retirement System (LRS) and National Guard Pension Fund (NGPF). The experience reviews resulted in changes to the demographic assumptions, economic assumptions and the funding methods for the systems. 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 TSERS, CJRS, LRS and NGPF that were originally presented at the October 22, 2015, meeting. Mr. Langer stated that the plan adoption of assumptions for the Disability Income Plan of North Carolina (DIPNC) and the death benefit plans will be presented at the April Board meeting.

It was moved by John Anarella, seconded by Greg Grantham, and carried that the Board adopt the proposed assumptions (the 7.25 percent discount rate, utilization of the Mortality Improvement Scale of MP-2015) and approve the Employer Contribution Rate Stabilization Policy. The following Board members voted in favor of the motion: Janet Cowell, John Anarella, Lentz Brewer, Jack Brooks, Van Dowdy, Greg Grantham, Alberta Hall, and LouAnn Phillips. The following Board members voted against the motion: Michael Mebane and Michael Jacobs.

Presentations on 2016 Fiscal Year Alternatives for TSERS, CJRS, LRS and National Guard

The Chair recognized Steve Toole for a presentation on the 2016 Fiscal Year Alternatives. Mr. Toole first presented the 2016 Fiscal Alternatives for TSERS. Based on assumptions adopted in 2010, the most recent valuation report shows that the new ARC of 8.47 percent is less than the state budget of 9.15 percent for the fiscal year ending 2016. 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 9.48 percent, which is greater than the state budget of 9.15 percent for fiscal year ending 2016. Therefore, the state budget allocated from the General Fund will need to increase by at least $32.7 million to meet the ARC using the proposed assumptions from the experience study, as modified for MP-2015. Further, based on the Board's adoption of the Employer Contribution Rate Stabilization Policy, contributions will be 0.35 percent greater than the appropriated contribution from the prior fiscal year. The following constraints apply: (1) contributions may not be less than the ARC, determined by using the assumptions adopted based on the experience study, including a discount rate of 7.25 percent; and (2) contributions may not be greater than the ARC, determined by using the assumptions adopted based on the experience study, but using a discount rate equal to the long-term Treasury bond yield. The Employer Contribution Rate Stabilization Policy results in a recommended contribution rate of 9.50 percent of payroll for fiscal year ending 2017, since this would be the minimum contribution after an increase of 0.35 percent to the prior appropriated contribution rate of 9.15 percent, which is greater than the 9.48 percent ARC determined during the experience study. Mr. Toole presented three policy options for the Board's consideration: 1) to recommend an increase to the current appropriation to fund the Employer Contribution Rate Stabilization Policy; 2) to recommend an increase to the current appropriation to fund the Employer Contribution Rate Stabilization Policy and a one percent COLA; or 3) recommend an increase to the current appropriation to fund the Employer Contribution Rate Stabilization Policy, increase the multiplier for active employees and a corresponding increase for all beneficiaries. It was moved by John Anarella, seconded by Van Dowdy, and carried that the Board recommend that the General Assembly increase the appropriation to 9.50 percent to fund the Employer Contribution Rate Stabilization Policy. The additional appropriation needed from the General Fund would be $34.7 million. The following Board members voted in favor of the motion: Janet Cowell, John Anarella, Lentz Brewer, Jack Brooks, Van Dowdy, Greg Grantham, Alberta Hall, and LouAnn Phillips. The following Board members voted against the motion: Michael Mebane and Michael Jacobs. Mr. Toole stated that the DIPNC and death benefit plans policy alternatives will be presented at the April Board meeting.

For Consolidated Judicial Retirement System, based on the assumptions adopted in 2010, the most recent valuation report shows that the new ARC of 25.09 percent is less than the state budget of 27.21 percent for the fiscal year ending 2016. However, subsequent to the valuation report, an experience study was performed. Based on the proposed assumptions from the experience study adjusted to reflect the latest mortality projection scale (MP-2015), the ARC for the fiscal year ending 2017 would be 28.53 percent, which is greater than the state budget of 27.21 percent for the fiscal year ending 2016. Therefore, the state budget allocated from the General Fund will need to increase by at least $937,200 to meet the ARC using proposed assumptions from the experience study, as modified for MP-2015. Mr. Toole presented two policy options for the Board's consideration: 1) to recommend an increase to the current appropriation to fund the ARC based on approved experience study assumptions, or 2) recommend an increase to the current appropriation to fund the ARC based on approved experience study assumptions and a one percent COLA. It was moved by John Anarella, seconded by Van Dowdy, and carried that the Board recommend that the General Assembly increase the appropriation to 28.53 percent to fund the ARC based on the approved experience study assumptions. The additional appropriation needed from the General Fund would be $937,000. The following Board members voted in favor of the motion: Janet Cowell, John Anarella, Lentz Brewer, Jack Brooks, Van Dowdy, Greg Grantham, Alberta Hall, and LouAnn Phillips. The following Board members voted against the motion: Michael Mebane and Michael Jacobs.

For the Legislative Retirement System, the most recent valuation report shows that the new ARC of 0.46 percent, which is less than the state budget of 1.80 percent for the fiscal year ending 2016. However, subsequent to the valuation report, an experience study was performed. Based on the proposed assumptions from the experience study adjusted to reflect the latest mortality projection scale (MP-2015), the ARC for the fiscal year ending 2017 would be 17.05 percent, which is greater than the state budget appropriated rate of 1.80 percent for the fiscal year ending 2016. Therefore, the state budget allocated from the General Fund will need to increase by at least $552,050 to meet the ARC using the proposed assumptions from the experience study, as modified for MP-2015. Mr. Toole presented two policy options for the Board's consideration: 1) to recommend an increase to the current appropriation to fund the ARC based on approved experience study assumptions, or 2) recommend an increase to the current appropriation to fund the ARC based on approved experience study assumptions and a one percent COLA. It was moved by Jack Brooks, seconded by Alberta Hall, and carried that the Board recommend that the General Assembly increase the appropriation to 17.05 percent to fund the ARC based on the approved experience study assumptions. The additional appropriation needed from the General Fund would be $552,050. The following Board members voted in favor of the motion: Janet Cowell, John Anarella, Lentz Brewer, Jack Brooks, Van Dowdy, Greg Grantham, Alberta Hall, and LouAnn Phillips. The following Board members voted against the motion: Michael Mebane and Michael Jacobs.

For the National Guard Pension Fund, based on assumptions adopted in 2010, the most recent valuation shows that the new ARC of $6,922,083 is less than the state budget of $7,066,299 for the fiscal year ending 2016. However, subsequent to the valuation report, an experience study was performed. Based on the proposed assumptions from the experience study adjusted to reflect the latest mortality projection scale (MP-2015), the ARC for the fiscal year ending 2017 would be $8,517,073, which is greater than the state budget of $7,066,299 for the fiscal year ending 2016. Therefore, the state budget allocated from the General Fund will need to increase by at least $1,450,774 to meet the ARC using the proposed assumptions from the experience study as modified for MP-2015. Mr. Toole presented two policy options for the Board's consideration: 1) to recommend an increase to the current appropriation to fund the ARC based on approved experience study assumptions, or 2) recommend an increase to the current appropriation of $2 million above the ARC based on approved experience study assumptions and to improve the funding status. It was moved by Van Dowdy, seconded by Lou Ann Phillips, and carried that the Board recommend that the General Assembly increase the appropriation to $10,517,073, which provides an increase to the current appropriation of $2 million above the ARC based on the experience study assumptions and to improve the funded status. The following Board members voted in favor of the motion: Janet Cowell, John Anarella, Lentz Brewer, Jack Brooks, Van Dowdy, Greg Grantham, Alberta Hall, and LouAnn Phillips. The following Board members abstained: Michael Mebane and Michael Jacobs.

<u>Presentation on Results of the Experience Review for the Disablity Income Plan of North Carolina and Death Benefit Plans</u>

The Chair recognized Larry Langer and Michael Ribble for a presentation on the results of the investigation of demographic and economic experience for the Disability Income Plan of North Carolina (DIPNC) 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 DIPNC. The assumption for the rate of disability from active employment was the source of the largest decrease in costs. They explained that the reasons for the decrease in rates are better access to healthcare, workplace safety and accommodation for modified work, as well as more rigor in disability determinations and approvals. The assumption for termination of disability status (due to death or recovery) was the source of the second 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.

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 TSERS 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 DIPNC and the death plans be accepted.

<u>Retirement Systems Division Operations Update</u>

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