

**MINUTES**  
**BOARD OF TRUSTEES**  
**OF THE LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM**  
**January 16, 2014**

The regular quarterly meeting of the Board of Trustees was called to order at 9:05 a.m., January 16, 2014, by the Chair, State Treasurer Janet Cowell. The meeting was held in the Natural Science Museum, 111 West Jones Street, in Raleigh.

Members Present

Board members present were: Janet Cowell, John Aneralla, Jerry Ayscue, Mike Bradley, Lentz Brewer, Randy Byrd, Loris Colclough, Kevin Gordon, LouAnn Phillips on behalf of Superintendent June Atkinson, Sally Sandy, and Grady Smith.

Members Absent

The Board members absent were: Chipp Bailey and Kay Cashion.

Guests Present

The guests attending were: Robert Curran, with the Attorney General's Office; and, Larry Langer, Michael Horton, Chandra Miller and Jim Ferreri, with Buck Consultants.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Koreen Billman, Mary Buonfiglio, Thomas Causey, Jay Chaudhuri, Joan Fontes, Jaclyn Goldsmith, Schorr Johnson, Fran Lawrence, Bryan Lewis, Lisa Page, Meredith Rouse-Davis, Kevin SigRist, Anthony Solari, Christina Strickland, 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.

Swearing in of Member

The Chair administered the oath of office to Randy Byrd.

### Approval of the Minutes

It was moved by Mike Bradley, seconded by Kevin Gordon, and carried that the minutes of the Board meeting held on October 17, 2013, be approved.

### Placement Agency Policy Discussion

To accommodate travel schedules, the update on the Department's Placement Agency Policy was advanced in the agenda. The Chair recognized Jay Chaudhuri, General Counsel of the Department of State Treasurer, for a presentation on the policy implemented by the Department pertaining to Placement Agents and additional disclosures. Mr. Chaudhuri explained to the Board that the purpose of the policy is to impose limitations on Investment Managers' use of Placement Agents and to ensure that Placement Agents play a proper role in marketing investment opportunities. Because the Department's Investment Management Division is limited in the number of staff it can hire and lacks legal authority to invest directly in certain assets, outside Investment Managers manage a majority of the investments made on behalf of the Department. Placement Agents are hired by outside Investment Managers and serve a valuable function by exposing new and emerging Investment Managers to investment funds. The Securities and Exchange Commission (SEC) recognizes the purpose of Placement Agents and allows Investment Managers to continue hiring Placement Agents. However, the SEC observed that some Placement Agents have been implicated in improper conduct affecting several public pension funds. If the Investment Manager is utilizing a pre-existing relationship between the Placement Agent and the public pension's staff, then the Placement Agent does not serve a useful function, and instead could cause a fund to make decisions based on factors other than the pension's investment strategy and expected performance.

In 2009, the Department retained Ennis Knupp to conduct an independent review and evaluation of the Investment Management Division. As a result of the findings and recommendations, the Department of State Treasurer implemented the Placement Agent Disclosure Policy.

The policy applies to all Investment Transactions and Substantive Amendments entered into by the State Treasurer on and after September 29, 2009. It requires Investment Managers to submit disclosure letters to the Department on the use of a Placement Agent. If there is a Placement Agent being used, then the Investment Manager must disclose the names of the Placement Agent personnel involved in marketing or outreach for the transaction and their resumes, statement of any actions or investigations by federal, state or local government made against a Placement Agent, and a statement confirming that the Placement Agent is registered with the SEC or the Financial Industry Regulatory Authority (FINRA). The letter must also include the disclosure of connections or relationships between the Placement Agent or Investment Manager to any actual or former staff, Board, or contractors associated with the Department of State Treasurer. The disclosure letters were also requested voluntarily from all Investment Managers hired prior to 2009 and the Department has received most disclosures from those Investment Managers.

In 2011, the Department Staff added Political Contributions to the policy. As a result, this policy now requires that the disclosure letter contain a list of all political contributions made, coordinated, or solicited by the Investment Manager and Placement Agent and their respective officers, partners, principals and affiliates for the campaign of any incumbent, nominee, candidate, or successful candidate for NC State Treasurer and for the campaign of the current State Treasurer running for a different office.

A special review was conducted by the State Treasurer's General Counsel and Kellogg Huber, an outside firm, in 2010. This voluntary review focused on commitments before Treasurer Cowell's first term. The review presented 32 recommendations. It was noted that 90 percent of those recommendations were already in place. Mr. Chaudhuri stated that there are a few recommendations that would need to be set by the General Assembly, including the recommendation for Placement Agents to be registered as lobbyists, a bill the Department will be working on this Session with the General Assembly.

Michael Jacobs asked how this policy compares to peers. Mr. Chaudhuri explained that this policy pertaining to Placement Agents is on par with the toughest in the country, with more enhanced disclosures than other public plans. Mr. Jacobs expressed that the Department policy should be written in a manner not to deter smaller niche money managers from their willingness to manage an investment mandate with the Department.

#### Retirement System's Legislative Agenda for the 2014 Short Session of the North Carolina General Assembly

The Chair recognized Anthony Solari, Director of Governmental Affairs, and Sam Watts, Policy Development Analyst for the Retirement Systems, for a presentation on the Department's legislative agenda for the 2014 Short Session of the North Carolina General Assembly. In addition to the Placement Agent legislation mentioned by Mr. Chaudhuri, Mr. Solari reported to the Board the conversations between the Department and legislators regarding the Separate Insurance Benefits Trust, as directed by the Board at the October 17, 2013, meeting. Mr. Solari presented the three Retirement System's bills to the Board: the Pension Spiking Prevention Act of 2014, the Retirement Administrative Changes Act of 2014, and the Retirement Technical Changes Act of 2014. Mr. Solari highlighted that the Pension Spiking Prevention Act would help prevent manipulation of the definition of compensation, establish a contribution-based benefit cap, and a pension spiking accountability measure. The Retirement Administrative Changes Act of 2014 would allow participants to name a beneficiary on the Contributory Death Benefit and further legislation on clarifying the procedure for the satisfaction of the Retirement System liability for Charter Schools that close. Lastly, Mr. Solari presented to the Board that the Department would like to pursue legislation that would provide for the return of contributions with accumulated interest for state and local employees who leave employment within 5 years, as well as legislation to restore the vesting period back to 5 years from 10.

### 2013 Comprehensive Annual Financial Report (CAFR)

The Chair recognized Fran Lawrence, Chief Financial Officer, for a presentation on the recently prepared CAFR for fiscal year ending June 30, 2013. Ms. Lawrence presented to the Board that the CAFR is a set of annual governmental financial statements that complies with governmental accounting standards and is gathered into a report on a yearly basis. The Office of State Controller owns the CAFR and the report is audited each year by the Office of State Auditor. The Department of State Treasurer's role in the CAFR is to maintain accurate accounting records and internal controls over all financial information for the Department. After adapting and compiling the CAFR report to comply with new accounting standards, the data is provided to the Office of State Controller. Ms. Lawrence presented that the 12 Pension Plans administered by the Department of State Treasurer are gathered into the report. Within these reports, the pension plans are described by actuarial methods and assumptions, the funding status, annual pension cost, and funding progress.

### Update on Governmental Accounting Standards Board (GASB) Accounting Changes

The Chair recognized Ms. Lawrence for an update on the GASB accounting changes. Ms. Lawrence presented that GASB's purpose for the two new Pension Accounting Changes (67 & 68) is for transparency and consistency of how governments calculate the pension liability and expense. Two new standards are GASB 67 (replacing GASB 25 and 50) for certain plans and will be effective as of fiscal year ending June 30, 2014, and GASB 68 (replacing GASB 27 and 50) as they relate to employers that provide plans to employees and will be effective starting fiscal year ending June 30, 2015. The changes by the GASB will require financial statements to contain new total and net pension liability calculated and disclosed the same way for all defined benefit plans.

### Separate Insurance Benefits Trust

The Chair recognized Sam Watts for an update on Session-Law 2013-360 that mandates the diversion of funds from the Separate Insurance Benefits Trust to reimburse employer paid State Health Plan premiums made on behalf of state law enforcement officers and to reimburse employer paid contribution rates for the State Health Plan based on the reported compensation of state law enforcement officers for fiscal years ending June 30, 2014 and June 30, 2015. Mr. Solari reported to the Board that the Board's resolution at the October 17, 2013, Board meeting was sent, as requested, to legislators and while the legislators understood their position, action to change the legislation will not likely be taken.

There was discussion by the Board on potentially not approving the transfer. The Board asked the Department's legal counsel for the potential effects of that decision. The Chair recognized Bob Curran, Special Deputy Attorney General with Department of Justice, to clarify the legal context to the Board on the issue. Mr. Curran explained that by Session-Law 2013-360, the permissible uses of that trust fund have been expanded and that the recent legislation changed the terms of the trust. Mr. Curran further explained, given the current funding status of the Trust, this action would not prohibit the trust from being able to provide the member benefits as mandated by statute. Therefore, at this time, this action is not deemed to be a violation of the

constitution. This position was confirmed by an outside law firm, Groom Law. It was moved by Loris Colclough to reluctantly approve the diversion as mandated by the legislature. There was no second and the motion failed. It was moved by Randy Byrd to not approve the diversion. There was no second and the motion failed. It was moved by Mike Bradley, seconded by Van Dowdy, and by majority vote (12:7), it was carried by the Board to approve the transfer for fiscal year 2013-2014 from the Separate Insurance Benefits Trust for the reimbursement of premiums paid for state law enforcement officers as set forth in Session Law 2013-360; and, to review the funding of that plan next year to ensure the Board's duties to the beneficiaries of that plan are not compromised. Voting against this motion was Treasurer Cowell, Jerry Ayscue, Randy Byrd, Jack Brooks, John Anarella, Michael Jacobs, and Michael Mebane.

#### Increase in the Amount of Reemployment Earnings Before Suspension of Retirement Allowance

The Chair recognized Steve Toole for a presentation concerning the annual statutory increase in the compensation that may be earned by a reemployed 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. Following the presentation, it was moved by John Anarella, seconded by Sally Sandy and carried that the amounts, which may be earned before suspension, shall be increased effective January 1, 2014, by the increase in the Consumer Price Index (CPI) as published by the United States Department of Labor. The increase in the CPI, for the period from January 1, 2013 to January 1, 2014, was 1.5 percent. Therefore, the maximum amount a reemployed retiree can earn without affecting his/her monthly retirement allowance is increased by the greater of 1.5 percent of the 50 percent compensation amounts or an adjusted amount of \$31,140.00, both effective January 1, 2014.

#### Annual Required Contribution (ARC) for Local System

The Chair recognized Larry Langer and Michael Horton for a presentation on the ARC projections for the Local Governmental Employees' Retirement System. Mr. Langer presented two baseline projections: a 7.25 percent expected market return and a 12.1 percent estimated market return for calendar year 2013. Both projections did not reflect a cost-of-living-adjustment. Estimated returns were almost 5 percent higher than expected. As a result, Buck is projecting lower contributions. In addition, for the first time since 2008, Buck is projecting unrecognized asset gains as of December 31, 2013, which means that contributions are more likely to trend lower over the next few years.

#### 2014 Fiscal Year Alternatives for the Local System and Budget Recommendations for Firefighters' and Rescue Squad Workers' Pension Fund

The Chair recognized Steve Toole for a presentation on the 2014 fiscal year alternatives for the Local Board to consider for the Local Governmental Employees' Retirement System.

#### 2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the Local Governmental Employees Retirement System

Mr. Toole discussed that the valuation report shows that the new Annual Required Contribution (ARC) of 6.94 percent is lower than the current employer contribution rate of 7.07 percent. Therefore, the Local Board of Trustees can decrease the employer contribution rate by 0.13 percent of payroll, or \$7.1 million to meet the new ARC for fiscal year ending 2015. Mr. Toole presented four policy options for the Board to consider: 1) to not change the current employer contribution rate of 7.07 percent to reduce volatility; 2) to decrease the employer contribution rate by 0.13 percent to meet the new ARC; 3) to recommend an increase to the employer contribution rate of 7.07 by .10 percent to fund the ARC and grant a one percent Cost of Living Adjustment, (the cost to employers to cover the ARC and pay for the COLA would be an additional \$5.5 million during the FYE 2015); or, 4) to recommend an increase to the employer contribution rate to fund the ARC, increase the multiplier for active employees, and a corresponding increase for all beneficiaries.

#### 2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the Firefighters' and Rescue Squad Workers' Pension Fund

Mr. Toole presented to the Board and discussed that the valuation report shows that the estimated ARC of \$15.1 million is higher than the current employer contribution of \$14,626,599 for the Firefighters' and Rescue Squad Workers' Pension Fund. Therefore, the Local Board could increase the employer contribution by \$500,000 to meet the new ARC. However, pending the review of the Data Cleanse for the Fund and a change in assumptions and methods, this could result in a decrease in the ARC in the future. Mr. Toole presented three options for consideration by the Board: 1) to recommend no change to the current employer contribution at \$14,626,599; 2) to recommend an increase in the employer contribution of \$14,626,599 by restoring \$500,000; or, 3) to defer decision until the April 2014 Board meeting to reflect the results of the Phase I Data Cleansing Analysis being done by Buck Consultants.

#### Court Cost Offset for Law Enforcement Officers

The Chair recognized Steve Toole for a presentation on the Court Cost offset for Local Law Enforcement Officers. Mr. Toole stated that the 2012 actuarial valuation of the Local Governmental Employees' Retirement System indicated that the Annual Required Contribution for 2014-2015 is 7.42 percent of payroll for law enforcement officers. For fiscal year ending 2015, the Court Cost offset will need to be reduced from -.27 percent to -.14 percent since net revenue to the retirement system from that source has decreased, leaving the ARC at 7.55 percent of payroll. Because the ARC for 2013-2014 is currently 7.55 percent for law enforcement officers, the ARC can be decreased by .13 percent (see LGERS) to meet the new ARC for 2014-2015. By doing so, the Board of Trustees may leave the employer contribution rate at the current level and still meet the new ARC at 7.42 percent.

#### Approval of New Local Employer

Mr. Toole presented the Town of Midway as an employer applying to participate in the Local Governmental Employees' Retirement System. It was moved by Loris Colclough, seconded by Lentz Brewer, and carried by the Board to approve the Town of Midway for participation as an

employer in the Local Governmental Employees' Retirement System, with an effective date of April 1, 2014.

#### Appointments of the Firefighters' and Rescue Squad Workers' Pension Fund Advisory Panel

Mr. Toole presented to the Board for consideration of the membership of the Advisory Panel for the Firefighters' and Rescue Squad Workers' Pension Fund. Mr. Toole stated that the Advisory Panel was created by Session Law 2013-284 as an extension of the Board of Trustees of the Local Governmental Employees' Retirement System. The Panel is to meet at least once a year to prepare an annual report to the Local Board on the status and needs of the Firefighters' and Rescue Squad Workers' Pension Fund. The Panel consists of seven members: Director of the Retirement Systems (Chair to the Advisory Panel) and a designee from the State Insurance Commissioner, with five appointed members that serve four year terms. These five appointed members must consist of: a paid firefighter; a volunteer firefighter; a paid rescue squad worker; a volunteer rescue squad worker; and, a representative at large from the general public. After the Board reviewed the recommendations; it was moved by Jerry Ayscue, seconded by John Aneralla, and carried by the Board to appoint Kevin Gordon to fill the position designated for a paid firefighter (and also fulfilling the requirement that a member be a member of the Local Board); Dean Coward to fill the position as a volunteer firefighter; Garry Whithman to fill the position of a paid rescue squad worker; Debra Poe to fill the position as a volunteer rescue squad worker; and Ken Mullen to fill the position designated as a representative of the general public. All five appointments are slated to serve a four-year term. It was noted that Rick McIntyre will serve as the State Insurance Commission designee.

#### Converting the Actuarial Valuation of the Firefighters' and Rescue Squad Workers' Pension Fund from Fiscal to Calendar Year

Mr. Toole updated the Board on a decision made to convert the actuarial valuation for the Firefighters' and Rescue Squad Workers' Pension Fund from a fiscal year basis to a calendar year basis to align the timing with all other North Carolina Retirement System's pension funds. This conversion will allow for more transparency and reporting in the Annual Report and further address the many moving parts. Mr. Toole stated that this will only result in a six-month delay; and the next valuation will be presented at the October 2014 Board meeting with all other systems.

#### Update on the Firefighters' and Rescue Squad Workers' Pension Fund Data Cleanse Project

The Chair recognized Jim Ferreri and Chandra Miller for a presentation on the findings and recommendations for Statement One for the Data Cleanse Project for the Fund. The Retirement Systems Division retained Buck Consultants to perform a valuation data audit for the approximately 40,000 members of the Firefighters' and Rescue Squad Workers' Pension Fund to assess the ability to create a lapse assumption that would reduce both future liabilities and the State's contribution requirement to the Plan. Under current assumptions, Buck Consultants assumes that all lapsed members will return to active roster service and ultimately become vested in their benefit. Mr. Ferreri presented the findings of the first groupings of data sampled, and found that:

Group one:

- Members who had service in the year of hire, then lapsed, then returned to service in 2004-2006 had a population of approximately 1,400 members.
- 69 of the 1,400 members were reviewed. It was found that although service was generally correct, service in 2004-2006 was not properly allocated to the appropriate year in many cases
- 34 of the 69 members had a lapse of 10 years or more.
- Subject to a full audit, Buck will assume 50 percent of this population will not return and become vested.

Group two:

- Members who only had service in their year of hire totaled approximately 2,400.
- 50 of the 2,400 members were reviewed.
- It was found that 27 out of the 50 were not on the roster in their year of hire and should never have been credited with service.
- Subject to a full audit, Buck will assume 50 percent of this population will not return and become vested.

Group three:

- Members who had a lapse of more than 6 years and returned to work totaled approximately 575 members.
- 117 members were reviewed.
- It was found that 75 out of the 117 members did not actually return to service after more than 6 years lapse.
- Subject to a full audit, Buck will assume 65 percent of this population will not return to become vested.

Given these findings on the probabilities of members returning after lapse and being vested in their benefit, Buck Consultants expects to remove at least 2,500 members who are not expected to return to active membership. This could result in a cost savings of \$2.2 million for the 2014-2015 contribution projections, including a \$1.7 million reduction from the current appropriation, pending the actual results of the full audit. Lastly, Buck Consultants recommended: 1) reviewing the entire lapsed population, 2) sending letters to multiple populations to encourage members over the age of 65 to apply for return of contributions, and 3) performing a death search on all lapsed population.

Mr. Gordon conveyed to the Board what he has been hearing in his position on the NC State Firemen's Association on the inaccuracy of member accounts and data rosters when members become eligible to receive their benefit. Mr. Toole shared that prior to commencing any benefit payments, a complete member service audit is performed to ensure its accuracy.

Public Comment



The Chair recognized the following organizations' representatives for oral and/or written presentations on retirement benefit proposals for the Board's recommendations to the upcoming 2014 Short Session of the General Assembly:

Lacey Presnell, North Carolina Retired School Personnel

Mark Jewel, North Carolina Association of Educators

Ed Reagan, North Carolina Retired Governmental Employees' Association

Ardis Watkins, State Employees' Association of North Carolina

Rebecca Troutman, North Carolina Association of County Commissioners

Whitney Christenson, North Carolina League of Municipalities

2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the Systems overseen by the Local Board of Trustees

The Chair recognized Steve Toole to lead the Board of Trustees through setting of 2014 Employer Contribution Rates and making recommendations to the North Carolina General Assembly.

2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the Local Governmental Employees' Retirement System

It was moved by Mike Bradley, seconded by LouAnn Phillips, and carried by the Board, by majority vote (10:1), to recommend that the North Carolina General Assembly increase the employer contribution rate to fund the ARC and a one percent COLA. A one percent COLA would result in an increase in the employer contribution rate for pension expenses from 7.07 percent of payroll to 7.17 percent for general employees and an increase in the net payable rate for pension and death benefit expenses for law enforcement officers from 7.42 percent of payroll to 7.52 percent of payroll. John Aneralla voted against the motion.

2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the Firefighters' and Rescue Squad Workers' Pension Fund

It was moved by John Aneralla, seconded by Kevin Gordon, and carried by the Board to defer the decision until the April 2014 meeting to reflect the results of Phase I Data Cleansing Analysis.


Director's Report

Mr. Toole presented the Director's quarterly update. With respect to Operations, he stated that there has been a steady increase in incoming emails by 19.8 percent over the past year. Retirement estimates and service purchases have slightly decreased from 2012 as self-service

retirement estimates views have increased by 28.9 percent. Lastly Mr. Toole updated that invoices from the Retirement Systems for new overpayments had increased by 12 percent from 2012 to 2013. Mr. Jacobs requested that the staff explore opportunities to study and report to the Board on how the North Carolina Retirement Systems compare to other similar plans across the country.

Adjournment

There being no further business, John Aneralla moved for adjournment of the meeting, which was seconded by Randy Byrd and carried. The meeting adjourned at 12:45 p.m.

  
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CHAIR

  
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SECRETARY