



DRAFT MINUTES
BOARD OF TRUSTEES
OF THE TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM

The regular quarterly meeting of the Teachers' and State Employees' Retirement System (TSERS) Board of Trustees was called to order at 9:31 a.m., October 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 acknowledged the bravery and passing of Master Trooper Kevin Keith Conner, who died in the line of duty earlier this month. He stated that Trooper Conner had served with the North Carolina Highway Patrol for 11 years and had previously served with the North Carolina Marine Patrol.

Members Present

The board members present were: Treasurer Dale R. Folwell, CPA, Vernon Gammon, Lentz Brewer (by phone), Greg Patterson, Claire Miller (on behalf of Superintendent Mark Johnson), Barbara Gibson, Dirk German, Margaret Reader, Joshua Smith, John Ebbighausen, Jeffrey Winstead, Oliver Holley (by phone) and Linda Gunter.

Members Absent

There were no board members absent.

Guest Attending

The guests attending were: Joseph Newsome with the Attorney General's Office and Larry Langer and Jonathan Craven of Cavanaugh Macdonald Consulting LLC.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Sam Hayes, Timeka Holden, Patrick Kinlaw, Fran Lawrence, Tawnya Lowe, Karah Manning, 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 the board members to review the agenda in order to determine whether any board members had an actual, potential or the appearance of a conflict of interest in these matters to be considered by the board members during the meeting.

No conflicts of interest were identified by the board members.

Public Comment

Richard Rogers, Executive Director of the North Carolina Retired Governmental Employees' Association, provided comments. He thanked the Chair and the board for their commitment to ensure the funding of the Retirement Systems and State Health Plan.

Approval of TSERS Minutes from the July 26, 2018, Meeting

It was moved by John Ebbighausen, seconded by Vernon Gammon and carried unanimously that the TSERS minutes from the July 26, 2018, meeting be approved.

Retirement Systems Division (RSD) Operations, Member Services and Compliance Updates

The Chair recognized Executive Director Steve Toole, Vicki Roberts (Deputy Director of Member Services), and Patrick Kinlaw (Director of Policy, Planning, and Compliance) for an administrative update. Mr. Toole reported that RSD's Operations section had a successful summer retirement season. The team processed approximately 13,070 retirements in the first nine months of 2018. The average turnaround time from application receipt to processing was approximately 14 days, which is faster than the goal of 30 days. He stated that 99.5 percent of all retirements were paid within 60 days. The team processed approximately 6,484 death notifications in the first nine months of 2018. The average turnaround was 14 days, which is faster than the goal of 20 days. The team processed 2,560 new disability applications in the first nine months of 2018. The average turnaround was 16 days, which is faster than the goal of 20 days. The team processed 11,595 refund requests in the first nine months of 2018. The average turnaround of eight days, which is faster than the goal of 15 days. He also reported on the ORBIT self-service inquiries processed during the twelve months ending in September 2018:

- 1,431,893 retirement estimates,
- 98,968 service purchase estimates,
- 377,127 beneficiary updates,
- 136,682 transfer benefit,
- 218,513 forms,
- 395,811 *myNC* Retirement Statements,
- 53,384 direct deposit,
- 136,860 statements of account,
- 11,012 maintain address, and
- 100,465 tax inquiries.

Mr. Toole also provided an update on the processing of retirements, which included a discussion about overpayments to be accessed upon approximately 40 retirees who selected a payment under Option 4 (Social Security Leveling) and whose benefit had not been reduced, as required, in the past when they turned age 62. Some board members shared concerns that retirees could be asked to pay back large overpayments, and that this placed a great burden on them. The Chair responded that unfortunately the system incorrectly paid a fraction of the members who elected Option 4, that the incorrect payments typically began many years ago and continued until they were recently identified, and that each affected retiree's account is being thoroughly reviewed to determine the amount of overpayment, if applicable. All affected retirees had their benefit reduced in August 2018 to the amount that would have been in payment if the benefit had been correctly reduced when they turned age 62. Staff has been

communicating with the affected retirees and overpayment recovery, if applicable, will not begin before January 2019.

The Chair recognized Deputy Director of Member Services, Vicki Roberts, for a presentation on the metrics for Member Services. Ms. Roberts reported that to date the Education Retirement Group's counselors received 22,115 letters and emails. She stated that the response turnaround time is approximately 2.5 days, which is faster than the goal of seven days. During the fiscal year to date (July through September 2018), the counselors hosted 35 group meetings with 3,162 members attending, held three employer training meetings with 60 attendees, and hosted 20 webinars with 733 attendees. Ms. Roberts reported that during the first nine months of calendar year 2018, there have been 2,304 scheduled individual counseling sessions, and another 2,482 office visitors (walk-ins). Ms. Roberts stated that the Call Center has reported 213,584 calls received during the first nine months of 2018, of which they answered 78 percent within 60 seconds. The annual goal for the Call Center is to answer 65 percent of all calls within 60 seconds.

The Chair recognized the Director of Policy, Planning and Compliance, Patrick Kinlaw, for an update on RSD's Compliance section and, in light of the board's discussion about overpayments, to provide further background on the process for reviewing situations that require adjustments to members' accounts.

Mr. Kinlaw reported that since the 2015 effective date of the law pertaining to Contribution-Based Benefit Cap (CBBC) liabilities, 67 LGERS retirements have required employer contributions through October 3, 2018. The total liabilities corresponding to those retirements, which have been invoiced to LGERS employers as of October 3, 2018, was about \$5.3 million. The average of these invoices was \$79,692.92, with a range from \$4,065.58 to \$472,690.28. Of the 67 invoices, 59 have been paid in full by employers, and the total amount collected from LGERS employers exceeds \$3.9 million. Mr. Kinlaw reported that overpayments recovered during the first quarter of the fiscal year (July through September 2018) totaled more than \$2.8 million, toward the goal for the fiscal year of \$10 million. Over the 13 months ending in September 2018, approximately \$12.1 million in overpayments were recovered.

With regard to required adjustments to members' accounts, Mr. Kinlaw stated that the compliance team works with staff throughout RSD to review and improve all processes that could result in account changes. The process for reducing "Option 4" retirees' benefits upon age 62 is one example of such a process, and Mr. Kinlaw noted other examples. The current review of the "Option 4" process, like many reviews, was initiated due to a staff observation about a member's account in the course of reviewing a different process. Rather than keeping the review isolated to a single member, the compliance team increasingly works to ensure an objective and comprehensive review, using data analytics methods to identify the group of accounts that require more intensive research. Mr. Kinlaw emphasized that RSD staff recognizes the seriousness of overpayments and the profound impact that repayment may have on retirees' finances. He noted that, as part of operating retirement systems on the scale of North Carolina's, RSD will continue identifying areas where adjustments are needed. Mr. Kinlaw stated that in these situations, RSD's goals include stopping problems before they become bigger, meeting RSD's obligation to pursue repayment of overpaid funds, and understanding the personal impact on members and their families.

The Chair reiterated that with regard to the group of "Option 4" retirees being discussed, RSD will work with the members or their representatives to come up with an agreement under which any overpayment may be repaid.

Update of the Investment Advisory Committee (IAC) Meetings

The Chair recognized Greg Patterson, member of the Investment Advisory Committee, to give an update on the IAC meetings. Mr. Patterson reported that due to market conditions the portfolio is essentially flat for the calendar year to date. Fees have been cut \$86.7 million annually. The portfolio continues to be invested with targets of approximately 40 percent in public equity, 30 percent in fixed income, and 30 percent in alternatives. The return attribution driven by the agency is a positive 126 basis points. Year to date the portfolio has a net outflow of \$2.7 billion, and the team is successfully managing an in-house index trading platform with \$10 billion under management, which is expected to ultimately grow to \$14 billion. The board discussed how additional detailed investment reports are available on the department's web site for review by the board and public.

Annual Report on Supplemental Retiree Insurance

The Chair recognized Executive Director, Steve Toole to give the Annual Report on Supplemental Retiree Insurance. Mr. Toole reported that Pierce Insurance Agency has administered and marketed the program effectively and efficiently since it was awarded the contract through a competitive bid process. The program has experienced an 85 percent growth rate with retirees under Pierce Insurance. Mr. Toole shared the available insurance products to retirees, current adoption numbers and associated monthly premiums.

Mr. Toole stated that the department recently completed successful negotiations with Pierce Insurance and UnitedHealthcare, which brought significant savings to retirees. The negotiated rate reduction for dental and vision benefits will result in a savings of \$1.2 million in premiums for retirees in 2019 and savings of \$1.5 million for retirees in 2020, totaling about \$2.7 million in premium savings for retirees over the next two years. Additionally, the new contract with UnitedHealthcare includes a performance rewards arrangement with an established benefits-to-claim ratio target of 85 percent. UnitedHealthcare will share (50/50) any profits as a result of a benefit-cost ratio better than 85 percent.

It was moved by Jeffrey Winstead to accept the report, seconded by Linda Gunter and unanimously approved.

Online Retirement Application Preview

The Chair recognized Karah Manning, RSD Communications Manager, to give a preview of the online retirement application. The goals and objectives of the new process are to spread the word by informing members and employers about the new online retirement application and to increase the percentage of users who apply online.

The online retirement application will launch on Tuesday, November 13, 2018, for members of TSERS and LGERS. The comprehensive communication plan spans the weeks leading up to the date of launch and beyond.

Ms. Manning stated that the target communication audiences are current teachers and state and local government employees (members of TSERS and LGERS only), employers participating in TSERS and LGERS, the North Carolina General Assembly, general public, media and third-party associations. The communication plan will include various collateral materials, which are being developed to effectively communicate the availability of this new member self-service tool in ORBIT.

Ms. Manning explained the step-by-step process of completing an application for retirement, and the expectations and requirements for each step. Members will apply online using ORBIT, which is a familiar tool. They will receive a wizard-like, step-by-step guide through their retirement application; and they will be able to view scenarios regarding how different retirement details may affect their retirement benefits. Help topics are integrated throughout. The tool will increase the likelihood of accurate data and decrease back-and-forth exchanges with members to ensure proper execution of members' wishes.

Members can choose the submission format preferred, and required documents are customized based on the member choices. A status message gives members an idea of where they are in the process, which should reduce calls from members seeking a status update. The program allows for messaging related to other key decision points.

The board had a robust conversation around the availability of the new self-service tool in ORBIT. The board discussed the possible use of an electronic signature tool thereby eliminating the need for a member to print, notarize and upload the required forms. The Chair responded that there are many instances of identity theft happening and how important it is to authenticate a member's identity. Staff confirmed for the board that the new online tool is not replacing members' ability to file paper forms. The board requested additional employer support and training for them to respond to member questions. Staff agreed to provide additional support as needed and reminded the board that the current processes for retirement remain unchanged for all employers. The online tool will provide robust education, videos and a full report on the available options, with their selections customized based on their specific entries. Retirement staff members will continue to work with employers to verify service, sick days, etc. Ms. Manning stated that members will have the ability to convert the information to a PDF for printing and saving on their personal device. Lastly, Ms. Manning shared that members are able to contact the Call Center and the department's web site to schedule an individual counseling session.

Policy and Legislative Update

The Chair recognized Patrick Kinlaw, F.S.A., Director of Policy, Planning, and Compliance, to provide a Policy and Legislative update. Mr. Kinlaw noted that legislation affecting the Retirement Systems and enacted during the 2018 "Short Session" of the General Assembly had been reviewed during the July 2018 board meeting, and that further discussion regarding the 2019 "Long Session" would likely occur at the January 2019 board meeting.

Mr. Kinlaw called the board's attention to the "Actuarial Transition Summary Memo" included in the Appendix to the board materials. He stated that later in the meeting, Cavanaugh Macdonald Consulting LLC (CMC) would present its first set of annual actuarial valuation reports as the board's consulting actuary, and that the summary memo prepared by Mr. Kinlaw provided information about identifiable changes resulting from the transition of consulting actuaries, as well as the approximate effects of those changes on liability amounts and contribution rates.

Mr. Kinlaw referenced an August 2018 publication by the consulting firm GRS entitled "Sustainability for Defined Benefit Pension Plans." He noted that RSD staff had used the checklist from that publication as a tool to assess the Retirement Systems' long-term sustainability. From this analysis, staff considered TSERS to be in a position of strength in most areas. In particular, staff considered that North Carolina has strong laws governing pension funding. It also considered the fact that the legislature has a history of making required contributions, TSERS is well-funded compared to many systems, funding gaps that develop are

closed relatively quickly, and that unfunded liabilities are paid down on a level-dollar schedule rather than as a percentage of payroll.

However, Mr. Kinlaw noted that the exercise illuminated some risks. Five risks stood out, of which staff considered three to be relatively manageable, and two to be large long-term risks.

The three relatively manageable risks enumerated by Mr. Kinlaw were as follows. First, the GRS paper suggested that all actuarial assumptions be reviewed in detail as often as once every three years. The comprehensive review of TSERS assumptions traditionally occurs once every five years, which staff believes is reasonable provided that there continues to be flexibility to adjust for significant intervening developments. Second, the GRS paper suggested that the assumed rate of return is ideally a rate with at least a 55 percent likelihood of being met, according to multiple independent sources. The rate of return for TSERS was determined based on approximately 50 percent likelihood of being met, according to a single study commissioned by the department. The third risk pertained to the funding policy of the Local Governmental Employees' Retirement System.

Mr. Kinlaw discussed two larger long-term risks as follows. First, TSERS continues to experience a long-term demographic shift, where the number of active employees is not keeping pace with the number of retirees. TSERS is not unique in seeing this trend, but it is significant. Mr. Kinlaw estimated that over the past ten years, the number of TSERS retirees and beneficiaries receiving payment has increased an average of four percent per year, while the number of active employees in the system has declined an average of one percent per year for TSERS. Over this time, the number of active employees per retiree has declined from 2.3 to 1.4. Mr. Kinlaw stated that an implication of this trend is that any unfavorable experience the system incurs in terms of investment experience, life expectancies, or otherwise will translate increasingly to dollars that must be funded by system employers, because they will be funded less and less by employees. Related to this point, Mr. Kinlaw noted that investment returns in the future would battle against an increasing headwind known as the "negative cash flow" (benefit payments in excess of contributions being made to the system). Currently, the negative cash flow for TSERS is approximately 2.5 to 3.0 percent of assets, but it is projected to grow to the range of 3.5 to 4.0 percent in the next 20 years. The second major risk that Mr. Kinlaw highlighted is the risk of benefits being added to the system that are not currently reflected in the actuarial valuation, for example, cost-of-living increases or benefit formula enhancements granted in the future. He noted that it is important to understand that the projected funded percentages and contribution rates in the actuarial valuation reports assume that no such benefit improvements will ever be granted. Therefore, any such benefit improvements would represent additional costs that have not been contemplated in actuarial valuations up to that point.

Mr. Kinlaw noted that as part of the department's commitment to improving the sustainability of all the benefit plans it administers, in August 2018 the department had requested the technical assistance of The Pew Charitable Trusts to conduct an independent stress-testing analysis based on projections for TSERS. Finally, Mr. Kinlaw updated the boards on two developments regarding Actuarial Standards of Practice (ASOPs): an exposure draft of ASOP No. 4 that, if implemented, would require all annual valuation reports to include a measurement of an "investment risk defeasement measure," essentially a liability intended to be measured at a risk-free discount rate, and ASOP No. 51, which will take effect later in 2018 and will require actuaries to include more discussion about risk in their valuation reports.

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

It was moved by Treasurer Folwell, seconded by Greg Patterson and carried unanimously by the Board 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. All attendees, other than the Board members and applicable staff, were instructed to exit the conference room and a separate telephone line was used. At the conclusion of the closed session, Joshua Smith made a motion to reopen the meeting, which was seconded by John Ebbighausen and carried unanimously by the Board.

Teachers' and State Employees' Retirement System Actuarial Valuation Principal Results

The Chair recognized Larry Langer and Jonathan Craven of CMC to provide the principal results of the actuarial valuation for Teachers' and State Employees' Retirement System as of December 31, 2017. Mr. Langer and Mr. Craven shared the key takeaways from their presentation. The actual market value returns were 13.49 percent, compared to the plan's 7.20 percent assumption. They noted a one-time cost-of-living supplement of one percent of annual benefit payments for retired members and survivors of deceased member's payable in October 2018. There is a change in discount rate from 7.20 percent to 7.00 percent as of December 31, 2017, with direct-rate smoothing of the change in the employer contributions rate over a three-year period. When compared to the December 31, 2016, baseline projections, TSERS experienced a lower funded ratio as of December 31, 2017, (87.9 percent compared to 89.7 percent) and a higher actuarially determined employer contribution rate for fiscal year ending June 30, 2020 (12.97 percent compared to 12.68 percent). Based on the actuarial losses recognized in this December 31, 2017, valuation, no Cost-of-Living Adjustment (COLA) effective July 1, 2019, could be funded by actuarial gains.

It was moved by Greg Patterson to accept the report, seconded by Jeffrey Winstead and carried unanimously.

Consolidated Judicial Retirement System Actuarial Valuation Principal Results

The Chair recognized Larry Langer and Jonathan Craven of CMC to provide the principal results of the actuarial valuation for the Consolidated Judicial Retirement System as of December 31, 2017.

It was moved by Jeffrey Winstead to accept the report, seconded by Greg Patterson and carried unanimously.

Legislative Retirement System Actuarial Valuation Principal Results

The Chair recognized Larry Langer and Jonathan Craven of CMC to provide the principal results of the actuarial valuation for the Legislative Retirement System as of December 31, 2017.

It was moved by Vernon Gammon to accept the report, seconded by Claire Miller and carried unanimously.

Disability Income Plan of North Carolina Actuarial Valuation Principal Results

The Chair recognized Larry Langer and Jonathan Craven of CMC to provide the principal results of the actuarial valuation for the Disability Income Plan of North Carolina as of December 31, 2017.

It was moved by Greg Patterson to accept the report, seconded by Joshua Smith and carried unanimously.

North Carolina National Guard Pension Fund Actuarial Valuation Principal Results

The Chair recognized Larry Langer and Jonathan Craven of CMC to provide the principal results of the actuarial valuation for the North Carolina National Guard Pension Fund as of December 31, 2017.

It was moved by Greg Patterson to accept the report, seconded by John Ebbighausen and carried unanimously.

Death Benefit Plans Actuarial Valuation Principal Results

The Chair recognized Larry Langer and Jonathan Craven of CMC to provide the principal results of the actuarial valuation for the Death Benefit Plans as of December 31, 2017. Mr. Langer and Mr. Craven shared that the deficit for the Retirees' Contributory Death Benefit Plan is smaller than past years, but there remains a \$26.6 million gap between assets and liabilities. The current assets and contribution rates of the Retirees' Contributory Death Benefit Plan are not adequate. The plan provisions and/or contribution rates should be changed to reverse this projected shortfall. Based on GASB 74 payout projections, assets will be exhausted by 2075. The board was reminded that in April 2016 they approved an increase in premiums for members who retire March 1, 2017, or later and decreased the interest rate paid on return of contributions to 1.20 percent for those who die prior to 24 months of coverage. Board members expressed agreement that the deficit of this plan should be monitored carefully and that additional changes to plan provisions or contribution rates may be needed in the future.

Mr. Langer and Mr. Craven indicated that the somewhat consistent surplus in the other death benefit plans results in changes not being needed at this time. As of December 31, 2017, there is a \$113 million surplus on the TSERS Death Benefit Plan and a \$20 million surplus on the Separate Insurance Benefits Plan for Law Enforcement Officers.

Dirk German moved to accept the report, seconded by Margaret Reader and unanimously approved by the board.

Board of Trustees Comments

The Chair recognized that this would be the last Board of Trustees Meeting for Sheriff Carson Smith, Jr., a member of the Board of Trustees for the Local Governmental Employees' Retirement System, and thanked him for his dedication and service.

Sheriff Carson Smith, Jr. thanked the board members for the opportunity to serve and stated that he was very impressed of how professional and efficient this department conducted itself

and of the dedication that was given to make sure that the State of North Carolina's employees were well taken care of.

Adjournment

There being no further business, and by unanimous vote, the meeting adjourned at 2 p.m.