North Carolina
Total Retirement Plans

Dale R. Folwell, CPA
STATE TREASURER OF NORTH CAROLINA
DALE R. FOLWELL, CPA

DRAFT 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 9:30 a.m., April 26, 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 new members of the Board to be sworn in, and thanked the departing members for their service. The Chair indicated there would be a public comment period for organizations and individuals to address the Board later in the agenda.

Members Present

The board members present were: Treasurer Dale R. Folwell, CPA, Lentz Brewer (by telephone), Allen Buansi, David Dear, Vernon Gammon (by phone), Kevin Gordon, Greg Patterson, Sally Sandy, Carson Smith and Ashley Wooten.

Members Absent

The board members absent were: Brenda Howerton, Aaron Meredith, and Claire Miller (on behalf of Superintendent Mark Johnson).

Guests Present

The guests attending were: Alisa Bennett, Jonathan Craven, Ed Macdonald and Cathy Turcot, all with Cavanaugh Macdonald Consulting, LLC.

Department of State Treasurer Staff Present

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

Ethics Awareness and Identification of Conflicts or Potential Conflicts of Interest

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

Introduction and Swearing-in of new member of the Board of Trustees of the Local Governmental Employee's Retirement System

The Chair introduced Mr. Allen Buansi as a member of the Board, who serves in the statutorily-required position that must be filled by a mayor or member of the governing body of a city or town participating in the Retirement System. Mr. Buansi was appointed by Governor Cooper and his term on the Board expires March 31, 2020. He was appointed on March 27, 2018, and sworn in on April 26, 2018.

The Chair administered the oath to Mr. Buansi, which was followed by a photo.

Approval of Resolution of Appreciation for the services of the Honorable John Aneralla

It was moved by Greg Patterson, seconded by Joshua Smith, and carried unanimously that the resolution of appreciation for the services of Mr. John Aneralla be approved.

Approval of Resolution of Appreciation for the services of the Honorable Mark Stohlman

It was moved by Kevin Gordon, seconded by Sandy Sally, and carried unanimously that the resolutions of appreciation for the services of Mark Stohlman be approved.

Approval of Resolution of Appreciation for the services of Michael Ribble and the team at Conduent, Inc. (State and Local)

It was moved by Greg Patterson, seconded by Jeffrey Winstead, and carried unanimously that the resolution of appreciation for the service of Michael Ribble and the team at Conduent, Inc., be approved.

Approval of Minutes for the Local Governmental Employees' Retirement System Minutes from the January 25, 2018, Meeting

It was moved by Carson Smith, seconded by Kevin Gordon, and carried unanimously by the Board that the minutes from the board meeting held on January 25, 2018, be approved.

Approval of Minutes for the Local Governmental Employees' Retirement System Minutes from the March 7, 2018, Special Meeting

It was moved by Kevin Gordon, seconded by David Dear, and carried unanimously by the Board that the minutes from the special board meeting held on March 7, 2018, be approved.

Approval of Medical Board Members and Update on Disability Programs

The Chair recognized Mr. Steven Toole, Executive Director of the Retirement Systems, for a presentation on the appointment recommendations for the Disability Medical Board. Mr. Toole reported to the Board that pursuant to N.C.G.S.§128-28(l) and G.S.§135-6(k), the Board of Trustees shall designate a medical board for administration of the Disability Income Plan of North Carolina (DIPNC) and LGERS Disability Retirement. Mr. Toole discussed improvements to the processes that the department is implementing for the review of disability applications. He stated that staff has developed additional case management procedures and the department is actively recruiting for a registered nurse to review files during the case management processing phase with the intention to ensure appropriate examinations are completed by licensed medical professionals prior to submittal to the Medical Board for further review.

Mr. Toole reported that the current Medical Board members are: Dr. Robert H. Fleming, specializing in General Medicine; Dr. Robert Gaddy, specializing in Internal Medicine; Dr. Bobby Sellers, specializing in Psychiatry; and, Dr. Nathaniel L. Sparrow, specializing in Ears, Nose, and Throat. Dr. Stephen N. Lang was recently recruited to fill the open orthopedic specialist position on the Medical Board.

Mr. Toole also discussed the compensation for Medical Board members. He remarked that the Medical Board meets once a week and that each member receives a stipend of $312.50 per meeting. He stated that this compensation package is far less than the usual amount in the industry, where each medical file for review may be compensated at roughly $500.

There was discussion by the Board on the disability approval process. The Chair stated that the department has an extensive agenda this Short Session of the North Carolina General Assembly, and he is meeting with various stakeholder groups on various items. He is focused on improving the process for disability applications as well as verifying doctor signatures and clarifying gainful employment requirements.

After Board discussion, it was moved by John Ebbighausen, seconded by Jeffrey Winstead, and carried unanimously by the Board to approve the current compensation of $312.50 per meeting (which includes onboarding/training and individual in-person consultation), and reappoint Dr. Robert H. Fleming, Dr. Robert Gaddy, Dr. Bobby Sellers, Dr. Nathaniel L. Sparrow, and appoint Dr. Stephen N. Lang.

Retirement Systems Division Operations

The Chair recognized Thomas Causey, Deputy Director of Operations, for an update on the Retirement System's operations department. Mr. Causey reviewed the key takeaways from the operations report, stating that summer retirement season is approaching, but retirement application turnaround times remain low. He reported the current implementation of the online retirement application is set to launch in Fall 2018, and Member Services had a successful first quarter with tax season. Mr. Causey noted that the 60-day paid on time rate for retirement processing is at 99.8 percent and that applications are still paid 90 percent on time if less than 60 days, but only 20 percent are paid on time if the application is received less than 30 days before retirement date. He gave a report on the death notification processing, noting that January and February have the highest number of death benefit cases, and the team processed them in just over 15 days, well within the goal of 27 days to close a death workflow. There was Board discussion on the mechanisms for collecting death notifications. Mr. Causey replied that staff retain reports from Governmental Data Analytics Center (GDAC) and a private company, The Berwyn Group, who provides a death match against member payee records.

Mr. Causey gave a report on the processing of disability applications, stating that the time from receipt of applications to processing for payment was averaging about 25 days. There was Board discussion on whether a 25-day processing range to processed and paid was typical in industry. Mr. Causey commented that since the applications are being checked more thoroughly before getting to the board, the board has less applications to review which reduces the turn-around time.

Mr. Causey reported on ORBIT Self-Service activity online, and he updated that staff is in process of implementing a new repository for Fire and Rescue turn-around documents online that would streamline submission into ORBIT.

Retirement Systems Division Member Services

The Chair recognized Deputy Director of Member Services, Vicki Roberts, for a presentation on the metrics for member services. Ms. Roberts reported on member correspondence metrics, stating that turn-around time has decreased from 12 days to three days in the past year. Ms. Roberts reported that counseling sessions are up 40 percent, and the process for requesting appointments has improved because there is now a dedicated appointment coordinator who can also direct questions for response that may not require an appointment. She stated that there were 680 counseling sessions and almost 800 walk-ins so far this year. Ms. Roberts also informed the Board that virtual counseling sessions are being offered to assist members who are hours away from Raleigh. Ms. Roberts also highlighted information on the call center. She reported that they have received 83,000 calls so far in 2018. To manage seasonal call-spiking, seasonal employees have been hired and the division has developed a new tool for the call center employees to use called the Digital Quick Reference to aid in the synchronization of communications which is reducing call times by saving time to research materials. Executive Director Steven Toole complimented the work of the call center staff and leadership for responding to members' needs so efficiently and effectively.

Retirement Systems Division Policy, Planning and Compliance

The Chair recognized the Director of Policy, Planning and Compliance, Patrick Kinlaw. Mr. Kinlaw reported on the Contribution-Based Benefit Cap (CBBC) Liabilities, stating that 154 retirements have required an additional employer contribution through April 4, 2018. The total invoices have been $14.2 million, and approximately $10 million has been paid to date. The Chair stated that employers have authority to set compensation of their employees; however, employers have the responsibility to pay for the retirement-related costs of the compensation without shifting that cost to others.

Mr. Kinlaw gave an update on the overpayment collections. He stated that overpayments, occur for many reasons, but most commonly relate to disability cases. There was Board discussion on the amount collected from the total overpayment liabilities. Mr. Kinlaw replied that the current overpayments outstanding are between $30-40 million; so about one-third of the existing overpayment balances are collected each year, but new overpayment balances are always arising. He gave an update on the Compliance Section's efforts pursuant to N.C.G.S. §105A. In December 2017, RSD submitted information regarding approximately 3,300 members with overpayment balances over $50 to DOR. As a result, approximately $32,000 was collected through March 2018, of which approximately $5,000 will be refunded to members due to the intercepted amount exceeding the overpayment balance. The Chair commented that the department is continuously seeking to improve processes to minimize the occurrence of overpayments.

Update on the Investment Advisory Committee (IAC) Meetings

The Chair recognized Greg Patterson to give a presentation on the IAC Meeting on February 15, 2018. Mr. Patterson provided an update on the department's initiative to obtain $100 million of incremental cost efficiencies over four years for the Retirement Systems investment program and Supplemental Retirement Plans. Mr. Patterson reported that cost-efficiencies have reached approximately $68 million through January 2018. He presented that the department's assets under management are currently at $127.8 billion as of December 31, 2017, and the market value of assets in the Retirement Systems surpassed $100 billion in January due to the high market returns. Mr. Patterson reported on the portfolio return, stating that as of December 31, 2017, the asset classes had positive returns and the Retirement Systems had the strongest performance since 2009. The final return for calendar year 2017 was 13.5 percent. Mr. Patterson remarked that 2018 so far has been volatile.

Mr. Patterson reported that the IAC had received a presentation on Capital Market Assumptions, and the takeaway from that presentation was that the Committee did not see an urgent need for a full Asset Liability Model (ALM) Study at this time. He stated that the Committee will likely revisit this topic once the new actuary for the Retirement Systems is fully in place.

Mr. Patterson gave a report on the Fixed Income portion of the portfolio that was presented during the last meeting of the IAC. He reported that long-term Fixed Income is underweight and short-term Fixed Income is overweight.

Lastly, Mr. Patterson reminded the Board that the department is currently recruiting for the Chief Investment Officer position.

Overview of Retirement Systems Division's Legislative Agenda for 2018 Short Session of the North Carolina General Assembly

The Chair introduced Senior Policy Advisor and Legislative Liaison, Edgar Starnes, and the Retirement Systems Division's Policy Director, Sam Watts, for an update on the department's legislative agenda for the 2018 Short Session of the North Carolina General Assembly.

Mr. Watts presented the four legislative bills being considered for recommendation in the 2018 Short Session. He provided an overview of proposed agency bill: "Financial Accountability, Integrity, and Recovery (FAIR) Act." If passed into law, the bill currently would:

- Prohibit pay-as-you-go funding policies for future Other Post-Employment Benefits (OPEB) plans.
- Prohibit hidden pension debt by requiring the General Assembly to create a reserve upon an initial increase in required contributions by state employers resulting from benefit increases funded by state appropriations.
- Eliminate ORP reciprocity with TSERS members first hired on or after January 1, 2021.
- Restrict Office of State Human Resources (OSHR) agreements that affect the State Health Plan to be approved by the Executive Administrator of the State Health Plan.
- Synchronize the short-term disability filing period with the long-term filing period
- Cause employers to pay short-term disability benefits for the entire duration of benefits (cease practice of reimbursing employers for the second six months of this period)

There was discussion by the Board on the impact of cost-of-living adjustments (COLAs). Staff replied that $1.3 billion of the pension debt was due to state-appropriated COLAs. There was discussion by the Board about the legislative proposal that would eliminate ORP reciprocity for new members, and the proposal to introduce requirements for employment settlements that include State Health Plan coverage.

Mr. Watts presented the key provisions in the "Retirement Complexity Reduction Act of 2018." If passed into law, the bill currently would:

- Simplify service purchase statutes to ensure compliance with federal law, improve internal consistency and increase ease of administration.
- Sunset three of the seven benefit payment options to members who retire on or after August 1, 2018. The three options that would sunset are: Option 4 (Social Security Leveling); Option 6-2 (Modified Joint & Survivor – 100% for named beneficiary); and, Option 6-3 (Modified Joint & Survivor – 50% for named beneficiary).

Mr. Watts provided an overview of the "Administrative Changes Retirement System/Treasurer" that would amend the governing membership of the OPEB Committee, provide personal immunity from civil liabilities for the Local Governmental Commission (LGC) and the North Carolina Capital Facilities Finance Agency, and make changes to the governance of the State Health Plan Board. The bill also addresses charter school withdrawal liabilities from the Retirement System.

Lastly, Mr. Watts presented the key changes in the "Technical Corrections Act of 2018" that would clarify interpretations of current state law, conform statutes to governmental accounting standards, correct errors and increase efficiency of administration.

Actuarial Services Transition Update

The Chair recognized the Director of Policy, Planning, and Compliance, Patrick Kinlaw, for a presentation on the progress of the transition of actuarial services from Conduent Inc. to Cavanaugh Macdonald Consulting, LLC ("CMC"). Mr. Kinlaw introduced four members of CMC's team, Ed Macdonald, Alisa Bennett, Cathy Turcot and Jonathan Craven, who provided information regarding the ongoing transition. The CMC team outlined the steps of the transition. They noted that they were programming software in an attempt to replicate Conduent's valuation results as of December 31, 2016. They described the information that they gathered from the Retirement Systems and Conduent, including member census information, detailed actuarial assumption tables and reconciliations of trust asset values. The CMC team noted that while their primary goal is to develop proper and accurate programming, a secondary goal is to replicate the prior actuary's valuation results as closely as possible. They shared information on standard actuarial industry thresholds regarding how closely the prior-year valuation results should be replicated before proceeding with the current-year valuation.

Presentation and Approval of the Investment Return Assumptions (State and Local)

The Chair recognized the Director of Policy, Planning, and Compliance, Patrick Kinlaw, for a presentation on the assumed long-term rate of investment returns for the Local Governmental Employees' Retirement System and the Firefighters' and Rescue Squad Workers' Pension Fund. Mr. Kinlaw noted that the Registers of Deeds' Supplemental Pension Fund and the Local Death Benefit Plans use a different assumption, and were therefore not included in the discussion.

Mr. Kinlaw stated that the Retirement Systems' staff recommendation, also supported by the Retirement Systems' consulting actuary, Cavanaugh Macdonald Consulting LLC ("CMC"), was that the investment return assumption for the applicable systems be reduced from 7.2 percent to 7.0 percent. Retirement Systems' staff recommended that the reduction to 7.0 percent be reflected fully, for purposes of financial reporting as of June 30, 2018, for purposes of determining the funded percentage as of December 31, 2017, and for applicable benefit administration purposes as of January 2019. Solely for purposes of determining employer contribution rates, Retirement Systems' staff recommended that the increase in contribution rates resulting from the assumption change be recognized gradually over a three-year period, a process called "direct rate smoothing." The end of the three-year period would coincide with the next anticipated full review of actuarial assumptions, scheduled for 2020, at which point the Board would review the assumption anew.

Mr. Kinlaw provided background information emphasizing the importance of this particular assumption to the Retirement Systems' valuations and financing, and summarized guidance published by the Actuarial Standards Board pertaining to the selection of actuarial assumptions such as the rate of investment return.

Mr. Kinlaw then outlined the rationale for the staff recommendation. Since the assumption is meant to be a forward-looking assumption specific to the Retirement Systems, he stated that the primary resource would be the most recent asset allocation study conducted by the Department of State Treasurer's Investment Management Division ("IMD"). The study was conducted in 2016. Since it was noted in a recent meeting of the Investment Advisory Committee that IMD's capital market assumptions had changed only modestly since the 2016 study, there was not an urgent need for a new study. Therefore, Retirement Systems' staff made its recommendation with reference to the 2016 study without any additional adjustments. According to the 2016 study, the median expected compound annual rate of return is 6.7 percent per year over the next 20-year period, and 7.1 percent per year over a 30-year forward-looking period. Given the subsequent persistence of the capital market conditions under which the study was conducted in 2016, Retirement Systems' staff recommended an assumption aligned with these long-term median expectations. The assumption of 7.2 percent exceeded the 30-year median expectation, while the recommended rate of 7.0 percent would fall between the 20-year and 30-year median expectations. While discussing the 2016 asset allocation study, in addition to noting the long-term median returns, Mr. Kinlaw recommended that the Board consider the potentiality of unfavorable outcomes, such as the fifth percentile and 25th percentile returns over a sustained period of time, and also consider the fact that the IMD asset allocation study, while predicting a long-term median rate of return consistent with the 7.0 percent recommendation, also predicted rates of return that were somewhat lower in the near term. Mr. Kinlaw noted the prudence of reducing the assumed rate of return from its current level in light of those forecasts and possible scenarios. He also summarized information on historical average investment returns of the Retirement Systems, as well as a National Association of State Retirement Administrators survey on investment return assumptions of large U.S. public retirement systems. He noted that Retirement Systems' staff had reviewed this historical information and survey data in developing its recommendation, and considered it consistent with the recommendation, although the primary rationale for the recommendation was the forward-looking IMD asset allocation study.

Mr. Kinlaw outlined a hypothetical numerical example of how the impact of the assumption change on employer contribution rates would be phased in over a three-year period, beginning with contribution rates for the fiscal year ending in 2020, and fully recognized within the contribution rates for the fiscal year ending in 2022. He noted that the phase-in would apply to the actuarially determined employer contribution (ADEC) rate prior to the application of any contribution rate stabilization policy.

Mr. Kinlaw estimated that the assumption change to 7.0 percent would result in an increase in the measurement of actuarial accrued liabilities for the applicable systems by two to three percent; a decrease of two to three percentage points in the measured funded percentage of the applicable systems and an increase in the employer contribution rates, prior to the application of any contribution rate stabilization policy, of two to 2.5 percent of pay by the end of the three-year phase-in period. For the Local Governmental Employees' Retirement System, where the covered payroll is approximately $6 billion per year, this would translate to additional ADEC amounts of $100 million to $200 million per year by the end of the three years. Some of these contribution rate increases might have been called for under the contribution rate stabilization policies, regardless of the change in the investment return assumption.

Mr. Kinlaw invited Ed Macdonald of CMC to share CMC's view on the Retirement Systems' staff recommendation. Mr. Macdonald noted that CMC supported the recommendation, based on the median expected returns from the 2016 IMD asset allocation study, and also noted that the increased contributions resulting from the assumption change would help to secure the benefit promise made to members.

Carson Smith made a motion to decrease the investment return assumption from 7.2 percent to 7.0 percent as of the December 31, 2017, actuarial valuations for the Local Governmental Employees' Retirement System and the Firefighters' and Rescue Squad Workers' Pension Fund and to use direct-rate smoothing to phase in associated employer contribution rates over the next three years. The motion was seconded by David Dear and carried unanimously by the Board.

Appointment of Members to the Firefighters' and Rescue Squad Workers' Pension Fund Advisory Panel

Mr. Toole gave a presentation on the Firefighters' and Rescue Squad Workers' Pension Fund Advisory Panel membership. He reported that the terms had expired on January 16, 2018 for four of the five members appointed by the LGERS Board. The member appointed by the LGERS Board whose term did not expire on this date was Mr. Gordon, who serves as the "paid firefighter" representative on the Advisory Panel and also fulfills the requirement that at least one Advisory Panel member appointed must also be a member of the LGERS Board. Mr. Toole reminded the Board of the Advisory Panel's responsibility to report on status and needs of the Firefighters' and Rescue Squad Workers' Pension Fund. Mr. Toole listed the three recommendations for reappointment to the Advisory Panel: Mr. Dean Coward, volunteer firefighter; Mr. Gary Whitman, paid rescue squad worker; and Ms. Debra Poe, volunteer rescue squad worker. Mr. Toole also presented a recommendation for a new member, Mr. F. Walter Beroth, as a member of the General Public, who would replace Mr. Ken Mullen. Mr. Toole noted that the LGERS Board will be making appointments for a four-year term of each member.

It was moved by Ashley Wooten, seconded by Sally Sandy, and carried unanimously by the Board to appoint Dean Coward, Gary Whitman, Deborah Poe and F. Walter Beroth, to the Firefighters' and Rescue Squad Workers' Advisory Panel with an appointment expiration date of January 16, 2022.

Public Comment Period

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

Richard Rogers provided public comments on behalf of the North Carolina Retired Governmental Employees' Association (NCRGEA).

Ardis Watkins provided public comments on behalf of State Employees Association of North Carolina (SEANC).

Board of Trustees Comments

The Chair asked the Board if there were any comments prior to adjournment of the meeting. Each Board member contributed remarks before adjournment.

Local System Adjournment

There being no further business before the Board, Greg Patterson moved to adjourn, which was seconded by Carson Smith, and the meeting was unanimously adjourned at 12:47 p.m.

Chair

Secretary