

**MINUTES**  
**BOARD OF TRUSTEES**  
**OF THE TEACHERS' AND STATE 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

The Board members present were: Janet Cowell, John Aneralla, Lentz Brewer, Jack Brooks, Loris Colclough, Van Dowdy, Greg Grantham, William Grey, Alberta Hall, Michael Jacobs, Michael Mebane, and LouAnn Phillips on behalf of Superintendent June Atkinson.

Members Absent

No Board members were absent from this meeting.

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 Members

The Chair administered oaths of office for Loris Colclough and Alberta Hall.

Approval of the Minutes

It was moved by Michael Mebane, seconded by LouAnn Phillips, and carried that the minutes of the Board meeting held on October 17, 2013, be approved.

## Update on Placement Agency Policy

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 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 Treasurer on or 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 further pursuing restoration of 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 that 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 Aneralla, 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.

Presentation by the Consulting Actuary on the Principal Results of Actuarial Valuations, as of December 31, 2012, by Buck Consultants for the Legislative Retirement System

The Chair recognized Larry Langer and Michael Horton, from Buck Consultants, for a presentation on the most recent Legislative Retirement System actuarial valuation. Mr. Langer provided some background to the Board on the transition and delivery from the Legislative Retirement System's actuary to Buck Consultants in 2013. Mr. Langer presented that the results of this valuation deviated from last year's valuation due to market value returns of 11.8 percent compared to the assumed rate return of 7.25 percent and payroll increased by 1.2 percent compared to an assumed 3 percent increase. These deviations resulted in a December 31, 2012, funded ratio of 123.3 percent compared to the 124.0 percent funded ratio determined by the December 31, 2011, actuarial valuation. Although no employer contributions are required for FYE June 30, 2015, over the next several years employer contributions will likely be necessary.

Annual Required Contribution (ARC) Projections for State System

The Chair recognized Larry Langer and Michael Horton for a presentation on the ARC projections for the Teachers' and State Employees' Retirement System. Mr. Langer presented two baseline projections: a 7.25 percent assumed rate of return and a 12.1 percent rate of return for calendar year 2013, both projections reflected a no cost-of-living-adjustment. Estimated returns were almost 5 percent higher than expected. As a result, Buck is projecting that the unfunded actuarial accrued liability will be lower, which means that employer contribution rates may flatten or decline in the near future. 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.

Cumulative Impact of Inflation of Retiree's Benefits

The Chair recognized Sam Watts for a presentation on the cumulative impact of inflation on retiree's benefits. Mr. Watts presented to the Board the Department's annual study of the cost-of-living-adjustments effect of inflation on real value of pension benefits and used examples based in the chart to evaluate the data.

#### 2014 Fiscal Year Alternatives for the General Assembly for the State and Judicial Systems & Budget Recommendations for the National Guard

The Chair recognized Steve Toole for a presentation on the 2014 fiscal year alternatives for the State Board to consider for the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System and the North Carolina National Guard.

#### 2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the Teachers & State Employees Retirement System

Mr. Toole presented that the new Annual Required Contribution (ARC) of 8.76 percent is higher than the allocation in the state budget of 8.69 percent for fiscal year ending 2014. Therefore, the state budget allocation from the General Assembly will need to increase \$7 million to meet the new ARC for fiscal year 2015. Mr. Toole presented three policy options to the Board: 1) to recommend an increase to the current appropriation from 8.69 to 8.76 percent to fund the ARC; 2) to recommend an increase to the current appropriation from 8.69 to 8.76 percent to fund the ARC and a one percent COLA; or, 3) to recommend an increase to the current appropriation from 8.69 to 8.76 percent 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 Consolidated Judicial Retirement System (CJRS)

Mr. Toole presented to the Board that the valuation for the Consolidated Judicial Retirement System shows that the ARC of 26.55 is less than the allocation in the state budget of 28.01 percent for fiscal year 2014. Therefore the state budget allocation from the General Fund can decrease by \$1,019,080 to meet the new ARC for fiscal year ending 2015. Mr. Toole presented two policy options to the Board: 1) to recommend no change to the current appropriation at 28.01 percent; or 2) to recommend a decrease to the current appropriation to fund the ARC to 26.55 percent, which would save \$1,019,080.

#### 2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the North Carolina National Guard

Mr. Toole presented to the Board that the valuation report for the North Carolina National Guard shows that the new recommended Employer Contribution of \$5,259,546 for fiscal year ending 2015 is less than the allocation in the state budget of \$7,007,443 for fiscal year ending 2014. Therefore the state budget allocation from the General Fund could decrease \$1,747,897 to meet the new ARC. The difference is due to higher than assumed market returns during 2012. Mr. Toole presented to the Board two options: 1) to recommend that the legislature leave the appropriation at \$7,007,443 to assist in raising the current funding ratio of 73.3 percent (which is lower than other Retirement Systems); or, 2) to recommend that the legislature decrease the current appropriation to \$5,259,546.

#### 2014-2015 Fiscal Year Alternatives for the General Assembly for the Disability Income Plan of North Carolina

Mr. Toole presented to the Board that the valuation report for the Disability Income Plan of North Carolina (DIPNC) shows that due to a higher than assumed market return, the ARC could decrease from the current appropriation of .43 percent to .41 percent. Mr. Toole presented to the Board two options: 1) to recommend to the North Carolina General Assembly to leave the appropriation at .43 percent; or 2) recommend that the General Assembly decrease the current appropriation of .43 percent to .41 percent of payroll.

Public Comment

The Chair recognized the following organizations' representatives for oral and/or written presentations on retirement benefit proposals for the Board to consider in making 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 State 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 Teachers' and State Employees' Retirement System (TSERS)

It was moved by John Aneralla, seconded by Michael Jacobs, and carried by the Board to recommend that the North Carolina General Assembly increase the current appropriation from 8.69 to 8.76 percent for fiscal year ending 2015 to fund the ARC for the Teachers' and State Employees' Retirement System.

2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the Consolidated Judicial Retirement System (CJRS)

It was moved by John Aneralla, seconded by Van Dowdy, and carried by the Board to recommend that the North Carolina General Assembly leave the current appropriation for the Consolidated Judicial Retirement System at 28.01 percent for fiscal year ending 2015 in order to pay down the unfunded liabilities sooner than projected and reduce the probability of the future need to increase the appropriation.

2014-2015 Employer Contribution Rate Recommendation to the General Assembly for the North Carolina National Guard

It was moved by Loris Colclough, seconded by John Aneralla, and carried by the Board to recommend that the North Carolina General Assembly leave the current appropriation for the North Carolina National Guard at \$7,007,443 for fiscal year ending 2015.

2014-2015 Fiscal Year Alternatives for the General Assembly for the Disability Income Plan of North Carolina (DIPNC)

It was moved by Michael Mebane, seconded by Michael Jacobs and carried by the Board to recommend that the North Carolina General Assembly decrease the appropriation from .43 percent to .41 percent for the fiscal year 2014-2015.

Director's Report

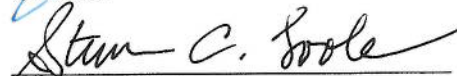
Mr. Toole presented the Director's quarterly update. With respect to Operations, he stated that there has been a steady increase in incoming emails by 19.8 percent over the past year. Retirement estimates and service purchases have slightly decreased from 2012 as self-service retirement estimates views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



CHAIR



SECRETARY