

MINUTES
BOARD OF TRUSTEES
OF THE TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM
January 17, 2013

The regular quarterly meeting of the Board of Trustees was called to order at 9:30 a.m., January 17, 2013, by the Chair, Janet Cowell. The meeting was held in the Dawson Conference Room at the State Treasurer's offices in Raleigh.

Before commencement of agenda items, the Chair, as State Treasurer, introduced Kevin SigRist as the new Chief Investment Officer in the Department of State Treasurer. She also expressed thanks to Bryan Lewis for his role as Interim Chief Investment Officer and for the work he has done assisting Mr. SigRist in this transition.

The State Treasurer introduced William (Bill) McGee as a new staff member who will be working with the Department's Director of Governmental Affairs, Anthony Solari, during this session of the General Assembly.

The Chair requested that the Board, staff and guests take a moment of silence in memory of Donald Tarkenton. Mr. Tarkenton was a member of the State and Local System's Boards of Trustees from January, 2009 to July, 2011.

Members Present

The Board members present were: Janet Cowell, Pearla Alston, Sam Barefoot, Loris Colclough, Dennis Ducker, Joyce Elliott, Shirley Harris, Harold Keen, Lou Ann Phillips on behalf of Superintendent June Atkinson, Sterling Primus and Pascal Swann.

Members Absent

The Board members absent were: Mark Foster, Harold Martin and Randy Sales.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Mary Buonfiglio, Joan Fontes, Jaclyn Goldsmith, Fran Lawrence, Bryan Lewis, Bill McGee, Lisa Page, Dani O'Quinn, Meredith Rouse-Davis, Joyce Rutledge, Anthony Solari and Sam Watts.

Guests Present

The guests attending were: Robert Curran, Susannah Holloway and Alexander Peters, with the Attorney General's Office; and, Larry Langer, Kai Petersen and Mike Ribble, with Buck Consultants.

Conflicts of Interest

The Chair asked, pursuant to the ethics rules, about conflicts of interest of Board Members. There were no ethics conflicts identified by the Board Members.

Approval of the Minutes

It was moved by Dennis Ducker, seconded by Lou Ann Phillips and carried unanimously that the minutes of the Board meeting held on October 18, 2012, be approved.

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 Pat Swann, seconded by Sam Barefoot and carried that the amounts which may be earned before suspension shall be increased effective January 1, 2013, 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, 2011 to December 31, 2012, was 1.7 percent. Therefore, the maximum amount a reemployed retiree can earn without affecting his/her monthly retirement allowance is increased by the greater of 1.7 percent of the 50 percent compensation amounts or an adjusted amount of \$30,680.00, both effective January 1, 2013.

Overview of Retirement System's Legislative Agenda for 2013

The Chair recognized Anthony Solari to make a presentation on the Retirement System's legislative agenda. Mr. Solari stated there will be a Technical Corrections bill submitted to the General Assembly and that bill will further align the Systems with State and federal laws. Mr. Ducker cautioned, with respect to the proposed expansion of the definition of "membership service", against unintended consequences. Sam Watts presented two provisions from the Administrative Changes bill to the Board: one provision would allow participants in the State's new 403(b) program to make a one-time election at retirement or following retirement to transfer any portion of his or her eligible accumulated contributions in the NC 403(b) plan to the Teachers' and State Employees' Retirement System; another provision would create a Preservation of the Benefits Plan for the purpose of providing benefits to a retiree or other beneficiary whose benefits would otherwise be limited by section 415 of the Internal Revenue Code. Discussion ensued with respect to the Administrative Changes bill. Mr. Ducker expressed the hope that the General Assembly would reconsider, and reverse, its legislation last session enacting a 10-year vesting period. The Chair replied that the Department has also seen impact from this change on recruiting qualified employees. Both the Chair and Mr. Solari indicated that many comments were being received regarding the preservation of the defined benefit plan.

Mr. Solari also announced that work was currently being done on a bill that would involve Board Governance changes and said that he would report further once a final bill had been developed.

Death Benefit Plans and Disability Income Plan of North Carolina Funding Status & Investment Allocation

The Chair recognized Larry Langer and Michael Ribble from Buck Consultants for a presentation on asset allocation for the Death Benefit Plans (DBP) and the Disability Income Plan of North Carolina (DIPNC). At the October 18, 2012, Board of Trustees meeting, questions had been raised by the Board relating to both the short-term investment allocations for the two funds and their overfunding. Mr. Langer explained that the practice of investing the DBP and DIPNC funds in only fixed income securities is due to concerns for liquidity and asset preservation in the short timeframe of expected benefit payments. Similar to DIPNC, death benefits are essentially being funded on a pay-as-you-go basis. The cost each year is expected to cover only that year's benefit payments. A plan can become overfunded due to actual numbers being less than the actuarial predictions, as has happened recently with the death rate, and to actual investment return exceeding the Interest Assumption.

2012 North Carolina Comprehensive Annual Financial Report

The Chair recognized Fran Lawrence, Chief Financial Officer for the Department of State Treasurer, to give a presentation on the recently completed Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2012, as it relates to Retirement Plans. Ms. Lawrence summarized the detail provided in Note 12 on the various retirement plans, and Note 14 on other postemployment benefits. She also shared information from Note 15 on the Death Benefit Plans and DIPNC. In connection with the Required Supplementary Information Schedules of Funding Progress for all the defined benefit pension trust funds, Ms. Lawrence reviewed ways in which the impending Governmental Accounting Standards Board (GASB) changes will affect the funding reports for these funds in future CAFRs, as reporting moves from actuarial to market values.

Asset Liability Modeling (ALM) Presentation and Annual Required Contribution (ARC) Projections

The Chair recognized Larry Langer and Kai Petersen for a presentation on the ALM study done by Buck Consultants for the Investment Management Division. Mr. Langer explained that the ALM study, based on the December 31, 2011 actuarial valuation, produces projections reflecting numerous externally influenced scenarios compared to the deterministic projections that have been shown to the Board previously. Using such modeling helps the staff better understand pension liability risks. Under ALM, changing assumptions in different scenarios (with differing values for items such as inflation, treasury yields, corporate bond yields, asset class returns and investment strategies) yields results showing the likelihood of certain events and a range of possible outcomes. Mr. Langer illustrated various scenarios from current year to 2040 with the main scenario of a Cost-of-Living-Adjustment (COLA) given annually compared to no COLA given annually. Those projections were paired with base pay increases compared to no base pay increases, and also with state contributions with an annual COLA and without an annual COLA. Lastly, Mr. Langer stated that these projections predicted a funded ratio for the Retirement System above 72 percent, which is in the fifth percentile, primarily due to a sound

funding policy and with an interest rate assumption of 7.25 percent that is projected to be achieved 75 percent of the time over the long-term.

The Chair commented that the increase in employer contribution rates, and the associated need for the General Assembly to increase appropriations to meet the increase in rates, puts continued pressure on the System.

Mr. Swann asked if a 10 percent employee reduction were ever to occur, whether that would have an effect on the projections. Mr. Langer answered that it would affect the projections, because a reduced employee group would bring savings to the System in terms of future payouts. However, he said the projections in this ALM study were based on stable population assumptions.

Recommendations to the 2013 Session of the General Assembly

The Chair recognized Steve Toole for presentation on possible recommendations that the Board of Trustees might make to the 2013 Session of the General Assembly. The Valuation report indicates a new Annual Required Contribution (ARC) of 8.69 percent, which is higher than the appropriated employer ARC of 8.33 percent for fiscal year ending June 30, 2013. Therefore the appropriations from the General Fund by the General Assembly will need to be increased by \$35.1 million to meet the new ARC. Mr. Toole presented three policy options to the Board: to recommend an increase from the current ARC to 8.69 percent; to recommend an increase from the current ARC to 9.05 percent and a one percent COLA to retirees; or, to recommend an increase from the current ARC to 9.10 percent and increase the accrual rate for active employees from 1.82 percent to 1.83 percent with a corresponding 0.55 percent increase to all beneficiaries. It was noted that the General Assembly's fiscal research division did a study on North Carolina plans and observed that the accrual rate for active employees was lower than in other states' pension plans. Formal decision was delayed for public comment.

Public Comment and Board Decision

The Chair recognized the following organizations' representatives for presentations on retirement benefit proposals for the Board to consider in making recommendations to the upcoming 2013 Session of the General Assembly:

Lacy Presnell, North Carolina Retired School Personnel

Ed Regan, North Carolina Retired Governmental Employees' Association

Mitch Leonard, State Employees' Association of North Carolina

Rodney Ellis, North Carolina Association of Educators

After public comment and a discussion, it was moved by Dennis Ducker, seconded by Loris Colclough and carried that the Board recommend that the General Assembly increase appropriations in order to meet the Annual Required Contributions for the Teachers' and State

Employees' Retirement System and the Consolidated Judicial Retirement System. Meeting these obligations means an increase in the employer contribution rate to 8.69 percent of payroll for the State System and an increase in the employer contribution rate to 28.01 percent of payroll for the Judicial System, all effective July 1, 2013.

Director's Report

The Chair recognized Steve Toole for his Director's Report. Mr. Toole gave an update on operations within the Division. Mr. Toole also discussed the Fraud, Waste, and Abuse Review that is currently being done by Buck Consultants, with recommendations due to the Division in the coming weeks. The results of the review will be available to be discussed at the next Board meeting.

Contested Case of James A. Layton, Petitioner v. North Carolina Department of State Treasurer, Retirement Systems Division, Respondent

The record in this Contested Case was not received by the Department in time for the parties to prepare and file their written exceptions and written arguments. It was moved by Loris Colclough, seconded by Sam Barefoot and carried unanimously that the hearing of this case by the Board be postponed until the next regular quarterly meeting.

Contested Case of Brenda C. Hemphill, Petitioner v. North Carolina Department of State Treasurer, Retirement Systems Division, Respondent

The Petitioner's Attorney was not present at the time the Contested Case was called to begin. The agenda had estimated a start time for the Contested Case at 1:15 p.m. and the case was called to begin at 11:45 a.m. Because of time constraints, the Board deliberated over affirming the Administrative Law Judge's decision or moving the hearing of the case to another date.

It was moved by Shirley Harris and seconded by Dennis Ducker that the Board uphold the decision of the Administrative Law Judge. That motion was defeated by a vote of 3 to 5. It was then moved by Pearla Alston, seconded by Shirley Harris and carried that the Board's hearing of the case be in a special meeting held by conference call prior to February 18, 2013, so that both parties would have the opportunity to present oral arguments to the Board.

Adjournment

There being no further business, the Chair announced adjournment of the meeting. The meeting adjourned at 12:15 p.m.


CHAIR


SECRETARY

