

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

A Board Orientation meeting was held on October 16, 2013. It was called to order at 1:00 p.m. by the Director, Steve Toole. The members present were: Lentz Brewer, LouAnn Phillips, John Aneralla, Michael Mebane, Jack Brooks, Van Dowdy, Greg Grantham, and Michael Jacobs. Members of staff present were: Steve Toole, Sam Watts, Jaclyn Goldsmith, Christina Strickland, Joan Fontes, and Bryan Lewis.

The Board Orientation covered an overview of the North Carolina Retirement Systems, North Carolina State Ethics, Open Meeting Laws, Roles and Responsibilities of a Trustee, Contested Cases, Public Policy, Investments, and an Actuarial Overview. The following guests and staff who gave presentations were: Steve Toole, Retirement Director; Bob Curran, Attorney General's Office; David Levine and Allison Tumilty, Groom Law Firm; Sam Watts, Policy Development Analyst; Bryan Lewis, Investments Management Division; and, Larry Langer and Michael Ribble, with Buck Consultants.

The regular quarterly meeting of the Board of Trustees was called to order at 9:30 a.m., October 17, 2013, by the Chair, State Treasurer Janet Cowell. At 12:00 p.m., Melissa Waller, Chief of Staff, stepped in as Acting Chair until adjournment of the meeting. The meeting was held in the Dawson Conference Room at the State Treasurer's offices in Raleigh.

Members Present

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

Members Absent

The Board members absent were: Alberta Hall and Grace Mynatt.

Guests Present

The guests attending were: Robert Curran and Susannah Holloway, with the Attorney General's Office; Larry Langer and Mike Ribble, with Buck Consultants; Vivian Pierce, with Pierce Insurance; Mary Harrison, with Buck Consultants; and David Levine, with Groom Law Firm.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Thomas Causey, Joan Fontes, Chris Frazier, Jaclyn Goldsmith, Schorr Johnson, Fran Lawrence, Bryan Lewis, Lisa Page, Meredith Rouse-Davis, Kevin SigRist, Tony Solari, Christina Strickland, Blake Thomas, and Sam Watts.

Conflicts of Interest

The Chair asked, pursuant to the ethics rules, about conflicts of interest of Board Members. John Aneralla stated a potential conflict with the Contested Case of Dwaine C. Coley, and therefore recused himself from the hearing.

Swearing in of Members

The Chair administered oaths of office for Lentz Brewer, LouAnn Phillips, John Aneralla, Michael Mebane, William Grey, Jack Brooks, Van Dowdy, Greg Grantham, and Michael Jacobs.

Resolutions

It was moved by Michael Mebane, seconded by LouAnn Phillips, and carried unanimously to adopt Resolutions for the services of Sam Barefoot and Harold Keen for their tenure on the Board of Trustees for the Teachers' and State Employees' Retirement System and the Board of Trustees for the Local Governmental Employees' Retirement System.

It was moved by LouAnn Phillips, seconded by John Aneralla, and carried unanimously to adopt Resolutions for the services of Pearla Alston, Randy Sales, Sterling Primus, Mark Foster, Shirley Harris, Joyce Elliott and Harold Martin for their tenure on the Board of Trustees for the Teachers' and State Employees' Retirement System.

Approval of the Minutes

It was moved by John Aneralla, seconded by Michael Mebane, and carried that the minutes of the Board meeting held on July 18, 2013, be approved.

Teachers' and State Employees' Retirement System Actuarial Valuation, Prepared as of December 31, 2012, by Buck Consultants

The Chair recognized Larry Langer and Michael Ribble from Buck Consultants for a presentation on the findings on the Teachers' and State Employees' Retirement System actuarial valuation. Mr. Langer presented that the results differed from the prior year due to a market value return of 11.8 percent compared to the 7.25 percent assumed return, and the results showed a decrease in payroll compared to the assumed three percent increase. These factors resulted in a slightly higher funded status of 94.2 percent compared to the projection of 92.6 percent; and, a lower employer required contribution rate of 8.76 percent compared to the previously projected 9.72 percent for fiscal year ending June 30, 2015.

It was moved by John Aneralla, seconded by Michael Mebane, and carried unanimously that the Teachers' and State Employees' Retirement System actuarial valuation report be accepted.

Consolidated Judicial Retirement System Actuarial Valuation, Prepared as of December 31, 2012, by Buck Consultants

Mr. Langer and Mr. Ribble presented the findings on the Consolidated Judicial Retirement System actuarial valuation. Mr. Langer presented that the results differed from the prior year due to a market return of 11.8 percent compared to the 7.25 percent assumed return and payroll increased by 0.6 percent compared to the 3 percent increase assumed. These factors yielded a higher funded ratio at 91.2 percent for the December 31, 2012 actuarial valuation compared to 89.9 percent from the December 31, 2011 actuarial valuation; and, a decrease in the Annual Required Contribution (ARC) rate to 26.55 percent for fiscal-year-end 2015, compared to 2011's valuation result of a 28.01 percent contribution rate for fiscal-year-end 2014.

It was moved by John Aneralla, seconded by LouAnn Phillips, and carried unanimously that the Consolidated Judicial Retirement System actuarial valuation report be accepted.

Disability Income Plan of North Carolina Actuarial Valuation, Prepared as of December 31, 2012, by Buck Consultants

Mr. Langer and Mr. Ribble presented the findings on the Disability Income Plan of North Carolina actuarial valuation. Mr. Langer presented that the results differed from the prior year due to a market return of 6.4 percent compared to the 5.75 percent assumed return and that payroll remained flat compared to the 3 percent assumed increase. These factors resulted in an increase in the funded ratio from 79.4 percent from the December 31, 2011 actuarial valuation to 86.0 percent from the December 31, 2012 actuarial valuation, and a decrease in the Annual Required Contribution rate from 0.43 percent of payroll to 0.41 percent of payroll.

It was moved by John Aneralla, seconded by Michael Mebane, and carried unanimously that the Disability Income Plan of North Carolina actuarial valuation report be accepted.

North Carolina National Guard Pension Fund Actuarial Valuation, Prepared as of December 31, 2012, by Buck Consultants

Mr. Langer and Mr. Ribble presented the findings on the North Carolina National Guard Pension Fund actuarial valuation. Mr. Langer presented that the funded ratio increased to 73.3 percent in the December 2012 actuarial valuation compared to the funded ratio of 70.4 percent from the December 31, 2011 actuarial valuation. Mr. Langer also reported that the appropriation for fiscal year ending 2014 is \$7,007,443; while the Annual Required Contribution for the 2014-2015 fiscal year is \$5,259,546.

It was moved by Michael Mebane, seconded by John Aneralla, and carried unanimously that the National Guard Pension Fund actuarial valuation report be accepted.

Separate Insurance Benefit Trust

The Chair recognized Sam Watts, Policy Development Analyst, to discuss recent legislation that amends N.C.G.S. §143-166.60 by diverting funds from the Separate Insurance Benefit 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. The Chair recognized Larry Langer, from Buck Consultants, to give a presentation on the estimation of the impact that these payments could have on the Separate Insurance Benefit Trust. Mr. Langer reported that the estimates presented were performed on the basis of two asset return scenarios (based on a 5.75 percent return and a 0 percent return), membership data, methods, and assumptions set forth in the December 31, 2012 actuarial valuation and that these estimates were determined by Buck Consultant's interpretation of the legislation. Based on the analysis of the estimates and data with a 5.75 percent return assumption, Buck Consultants found that if the funds were diverted for the complete two fiscal years, it is estimated that by fiscal year ending 2015, the surplus of the plan could decrease to a surplus of \$9.4M compared to a surplus of \$72.7M if no funds were diverted for payments. Alternatively, Mr. Langer presented an analysis with a 0 percent return by fiscal year end 2015 and if the funds were diverted for two complete years, the plan would be at a deficit of \$1.2M compared to a surplus of \$57.6M if no funds were diverted.

The Chair recognized Blake Thomas, Assistant General Counsel at the Department, and David Levine, from Groom Law Firm, to provide a legal analysis of the issue to the Board. Mr. Thomas explained that the initial transfer is required by state law, but that future transfers may violate the constitution. Based on Buck's projections, if the General Assembly takes the same action in the next biennium, the fund could be depleted in 2016. If the fund is depleted and therefore cannot provide benefits, then the fund would not be able to fulfill its contracts with its beneficiaries and there could be a violation of the contracts clause in the constitution.

A motion was made by Mike Bradley, seconded by Jerry Ayscue, and unanimously carried that Department staff draft a letter to the General Assembly on behalf of the Board explaining the potential conflicts of this legislation and the Board's position.

After discussion, the Board took a one hour break for lunch. When the Board reconvened, Melissa Waller stepped in as Acting Chair for the remainder of the meeting.

Death Benefit Plan Actuarial Valuation, Prepared as of December 31, 2012, by Buck Consultants

Mr. Langer and Mr. Ribble presented the findings on the Death Benefit Plans actuarial valuation. Mr. Langer presented that the Death Benefit Plans for the Teachers' and State Employees' Retirement System and the Local Governmental Employees' Retirement System plans have a surplus. The Retirees' Contributory Death Benefit reported a deficit of \$12.5M. The plan provisions and/or contribution rates for the Retirees' Contributory Death Benefit may need to be modified to reverse the projected shortfall.

It was moved by John Aneralla, seconded by Michael Jacobs, and carried unanimously that the Death Benefit Plans actuarial valuation report be accepted.

Presentation by Buck Consultants on the Review and Evaluation of Fraud, Waste, and Abuse

The Acting Chair recognized Mary Harrison, with Buck Consultants, to give a presentation on the research findings in the Report conducted by Buck Consultants on Fraud, Waste, and Abuse. The Board of Trustees received the final written report. Ms. Harrison presented to the Board that overall there were no significant risks of fraud or abuse, but there

were opportunities to minimize waste. Ms. Harrison explained that although pension spiking is not widespread, there are potential risks of pension spiking that can be addressed. These risks are due to the reliance on reporting through an "honor system" process; the practice (due to staff's time limitations) of only researching cases when the pensionable earning increases exceed 250 percent; inconsistent sick leave policies among agencies; and inconsistent definitions of compensation across the systems. Ms. Harrison then addressed recommendations for resolving pension spiking issues, which include implementing new review processes, changes in legislation, and changes to employer oversight. Ms. Harrison presented on the staffing review portion of the report that found a lack in formal succession planning, too much use of long-term contract labor and a need for realignment of certain accounting section responsibilities. Based on the findings, Buck recommended establishing a formal compliance team that would be responsible for oversight, research, and education to manage compliance by both employers and plan participants, to lessen the reliance on "honor system" reporting, and to redefine the roles and responsibilities for the Retirement Systems Division and the Financial Operations Division. Ms. Harrison commented that this review found that staff was very committed to the work.

As a result of this strong work ethic and due to lack of staffing, employees often take on duties beyond their current position descriptions to address needs as they arise, so many roles are not clearly defined.

Director's Report

Mr. Toole presented the Director's quarterly update. With respect to Operations, he stated that the visitors to the Retirement Systems and incoming calls have increased, and that there has been a steady increase of incoming emails by 15 percent. However, Retirement estimates and service purchases have slightly decreased from 2012. Disability applications have decreased by 13 percent, and refund requests have increased by 22 percent. Mr. Toole stated that the average monthly amount paid to beneficiaries is \$1,561, which is a 0.5 percent increase from 2012. Mr. Toole concluded by stating that the increase of members using self-service tools has lightened some work in Retirement Processing related to retirement estimates, beneficiary changes, and service purchases.

Mr. Toole updated the Board on his recent trip to the National Council of Teacher Retirement and some of the discussions at that conference. Lastly, Mr. Toole provided information to the Board on the Supplemental Insurance offerings through Pierce Insurance and the connection the Board may have on Supplemental Insurance in the future.

"Contested Case of Dwaine C. Coley, Petitioner v. North Carolina Department of State Treasurer, Retirement Systems Division, Respondent"

Mr. Aneralla recused himself from the contested case hearing and left the meeting.

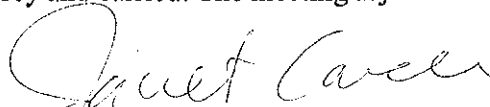
The Petitioner and the Petitioner's Attorney were not present for the Contested Case hearing. The Board heard oral arguments from Susannah Holloway, representing the Respondent. At the close of oral argument, it was moved by Michael Mebane, seconded by William Grey, and carried that the Board go into executive session to deliberate on the Contested Case. Melissa Trippe, Special Deputy Attorney General, acted as legal advisor to the Board.

At the close of executive session, it was moved by LouAnn Phillips, seconded by Lentz Brewer, and carried that the Board return to open session.

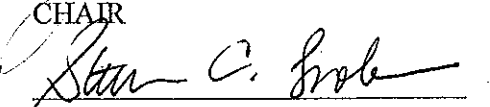
The Acting Chair then announced in open session that the Board had decided to uphold the Administrative Law Judge's Decision in its entirety in the aforementioned Contested Case.

Adjournment

There being no further business, Lentz Brewer moved for adjournment of the meeting, which was seconded by William Grey and carried. The meeting adjourned at 2:50 p.m.



CHAIR



SECRETARY