

DRAFT – MINUTES
(Unofficial and not in final form)

BOARD OF TRUSTEES
OF THE TEACHERS’ AND STATE EMPLOYEES’ RETIREMENT SYSTEM

The regular quarterly meeting of the Board of Trustees was called to order at 9:30 a.m., July 21, 2016, by the Chair, Deputy Chief of Staff, Schorr Johnson, designee of the State Treasurer. The meeting was held in the Dogwood Conference Room of the Longleaf Building at 3200 Atlantic Avenue, Raleigh, NC 27604. The Chair notified attendees that there would be a public comment period for organizations and individuals to address the Board. The Chair gave an update on Board vacancies and pending appointments.

Members Present

The Board members present were: Schorr Johnson designee of Treasurer Janet Cowell, John Aneralla, Lentz Brewer (by phone), Van Dowdy (by phone), Greg Grantham, Colonel William Grey (by phone), Terry McCann, Michael Mebane, Greg Patterson, Lou Ann Phillips and Veronica Wright. As the Director of OSHR, Neal Alexander was present, but his official appointment was pending at the time of the meeting. As such, Mr. Alexander was a non-voting attendee at the meeting.

Members Absent

The Board member absent was: Jack Brooks.

Guests Present

The guests attending were: Robert Curran, from the North Carolina Attorney General’s Office; Michael Ribble, Larry Langer, Susan Rosenbleeth and Lisa Townley from Buck Consultants; Bruce Hopkins from CEM Benchmarking; and Michael McCann from Prudential Retirement Services.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Bryan Allard, Nick Byrne, Thomas Causey, Angela Cooper, Joan Fontes, Jaclyn Goldsmith, Sherry McLamb, Vicki Roberts, Kevin SigRist, Anthony Solari, Edgar Starnes, 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. There were no conflicts of interest identified.

Introduction and Swearing in of Board Members

Greg Patterson, Terry McCann, and Veronica Wright were sworn in as new members of the Board.

Approval of the Minutes from the April 21, 2016 Board Meeting

It was moved by Lou Ann Phillips, seconded by Greg Patterson and carried unanimously that the minutes from the Board meeting held on April 21, 2016, be approved.

Retirement Systems Division Operations

The Chair recognized Thomas Causey, Deputy Director of Operations, and Vicki Roberts, Deputy Director of Member Services, for an update on Retirement Systems Division (RSD) operations. Mr. Causey gave a report on the metrics for operations. He stated that the Retirement Processing section is currently processing 99.8 percent of retirements within 60 days as of May 2016. He noted that July is the busiest month which impacts turnaround time. He also mentioned that the number of retirees for July equaled 3,700 this year. Mr. Causey stated that the Benefits Processing section is meeting its goal for processing disability applications. He noted that the number of disability applications has gone up some but turnaround times have gone down. The new supervisor has made a point to work on turnaround time. Mr. Causey reported that the Benefits Processing section is currently meeting its goal of processing death benefits under the goal of 40 days. He mentioned that there has been an increase in the number of death notifications but turnaround time has gone down and beneficiaries have been paid quickly. Refund requests are being processed in 30 days, exceeding the goal of 35 days. He mentioned that turnaround time is up on refunds because of the changes that have been implemented for processing required minimum distributions. He also mentioned that 800 additional members needed to be located to determine if they should be paid. RSD has been able to track down most of the members. Turnaround time is expected to return to normal. Mr. Causey reported that there are currently 294,181 payees in the system (expects to hit 300,000 soon) with the average monthly benefit of \$1,588. He stated that monthly payroll paid by the Retirement Systems Division is \$467,213,073 and that this number is expected to increase because of the anticipated increase in the number of retirees.

Mr. Causey reported that there are many members accessing the ORBIT self-service. They are in the midst of updating self-service by adding increased security and developing the capability for members to retire online.

Ms. Roberts gave an update on the metrics for Member Services. She reported that for the fiscal year so far, the Imaging Group processed over 502,000 documents in half of a day. She stated that the Education Retirement Group (ERG) continues to educate employees and employers on retirement readiness around the state. Benefit counselors travel around the state to educate on retirement readiness, and meet with members to counsel on retirement issues to improve retirement readiness. She stated that so far this fiscal year they received over 22,000 pieces of correspondence and responded to them within an average of 10.5 days; normal turnaround is 4 days but the turnaround time was higher due to low staff level. For the fiscal year, they held 173 meetings with a total of 10,500 attendees, surpassing their goal of 170 meetings for the year. They also had over 4,500 counseling sessions and office visits (consisting of about 950 scheduled retirement counseling sessions and 3,600 walk-in office visits). In June, three retirement readiness tours were conducted in Elizabeth City, Rocky Mount, and Asheville. The tours were a big hit and everyone appreciated the information. An ERG manager was hired and there are two additional spots that need to be filled.

The Call Center has been recruiting, hiring and training additional staff. So far this fiscal year (July – May) the Call Center received over 274,000 calls with an average of 25,000 calls per month. The average service level for the year was around 27%, but for May, the service level was 79.9%. The goal is 70% of calls answered in 30 seconds or less. There are now 34 people who have been hired. The goal is to maintain a staffing level of 34 all year long. The Call Center now has 100% of calls recorded, which was implemented in June and a new call quality monitoring program is beginning in September. She reported that the focus for the Call Center is on call resolution. There is a new Work Force Management tool to

help allocate the right number of resources for the right times with the right skills. She mentioned that since July there have been 8 training classes held for the call center each with a training period that is 5-6 weeks long. There was a question about the turnover of call center staff. Ms. Roberts reported that there is a positive turnover due to promotions and that the turnover rate is not high compared to the private sector. She said that they have partnered with Temporary Solutions to recruit temps that might be able to become permanent when a slot opens up. There are currently 15 temporary call center representatives.

The Chair recognized Nick Byrne who reported on RSD compliance efforts. He updated the Board that RSD has recovered \$8,786,051 in overpayments in the past 13 months. He reported that 75-80% of overpayments are due to offsets to disability benefits for workers compensation, social security benefits, and other sources of disability income. RSD's stated goal is to collect at least \$7 million in overpayment amounts due to the Retirement Systems on an annual basis. There was an inquiry about what happens if a member disagrees with RSD's assessment of an overpayment, and Mr. Byrne responded that there is a standard appeals process for aggrieved members to pursue. Mr. Byrne reported there are several methods employed to collect overpayments. RSD can negotiate payment plans, deduct overpayments from future benefit payments that the member might be eligible to receive, and coordinate with the Department of Revenue to recoup funds owed to payees. Most members set up an installment plan to pay the money back. There was an inquiry about the potential amount that can be collected. Mr. Byrne stated that RSD has identified about \$30 million in overpayments arising mostly due to disability benefit offsets requiring disability recipients to repay RSD dollar-for-dollar in the amount of other benefits received from Workers' Compensation awards, Department of Veterans' Affairs benefits, and Social Security disability awards. There was a follow-up question from Mr. Bradley about whether any of the \$30 million was uncollectable. Mr. Byrne answered that they plan to collect what they are legally required to collect and that RSD has identified approximately \$10 million in overpayments that are unlikely to be recouped for various reasons. To assist in collecting overpayments, RSD is adding staff to the Compliance Section with the hiring of a Member Compliance Manager, who has an auditing background and who will focus part of her efforts on reducing the amount of initial overpayments.

Mr. Byrne went on to report that 53 retirees (including 36 TSERS employers and 13 LGERS employers) have been invoiced for contribution-based benefit cap (CBBC) liabilities. The total CBBC liabilities invoiced to participating employers as of July 2016 is \$5.9 million. The average CBBC liability per retiree is \$110,557.27. Thirty-six participating employers have paid their additional employer contributions in full. Payment plans (not to exceed 12 months) are available. The law allows 90 days to enter into an installment plan to repay the additional employer contributions. To date, RSD has collected almost \$3 million in additional employer contributions pursuant to the CBBC law (almost 60% of total due). Shannon Wharry, the Employer Compliance Manager, was hired in March to supplement this work. RSD has provided informational materials and presented at various conferences to assist employers in better understanding the impact of the CBBC law and to provide insight into planning for potential CBBC-impacted retirees. Total CBBC liabilities collected exceeds \$2.7 million. Steve Toole also reported that Sherry McLamb was recently hired to lead Communications for RSD.

There was a request for Steve Toole to provide the new Board members with an overview of the establishment of the Compliance Section to address the overpayments and the process for recoupment. Mr. Toole reported that RSD received approval from the North Carolina General Assembly to hire several new employees, stating that for every dollar invested in RSD the Compliance Section would return \$5 to the system. RSD prioritizes the collection of overpayments and makes every effort to recoup these funds.

There is a pension fraud hotline where the public can report members who are not compliant and/or collecting money that is not due them. Two benefit analysts work on identifying overpayments. The Compliance Team is evaluating current process to explore the potential of recouping more funds in the future.

2016 Retirement Systems Division Legislative Update

The Chair recognized Tony Solari, Director of Governmental Affairs, and Sam Watts, Policy Development Analyst, to give updates on the Retirement Systems Division's legislative agenda for the Short Session of the General Assembly, as well as to provide a high-level update on several federal legislative and regulatory matters pertaining to the NC Retirement Systems. RSD was pleased that the General Assembly fully funded the actuarially required contribution.

Sam Watts highlighted key provisions of the retirement-related bills:

House Bill 1030, the 2016 Appropriations Act, fully funds the Annual Required Contributions for all of the Retirement Systems. Section 36.21 provides for a one-time pension supplement payment in the amount of 1.6% of annualized benefit. Section 36.23 eliminates the sunset contained in Session Law 2013-405 which established the Qualified Excess Benefit Arrangement (QEBA). The QEBA replaces benefits the member would have received, but for the IRS limits on pension benefit payments. Those members who retire prior to August 1, 2016 are paid from the fund. For members who retire after August 1, 2016, the last employer of that member is responsible for reimbursing the QEBA in the amount of any supplemental benefit made to the payee. This change should encourage local employers to be cognizant of employee compensation when hiring. Approximately 23 members are covered by the QEBA; approximately 100 are anticipated to qualify eventually.

Section 22.2, the Achieving a Better Life Experience (ABLE) Program Trust Report, requires DST to report to the Joint Legislative Oversight Committee on General Government on the status of the NC ABLE Program no later than December 1, 2016. Mr. Watts explained that the ABLE program allows families of developmentally challenged members to set-up a savings account, similar to a college savings account.

Section 27.1, Budget Transparency for Department of State Treasurer, requires the Office of State Budget and Management to study and report on the feasibility of converting operating funds within the Department of the State Treasurer from receipt-supported to General Fund-supported. The report is due to the December 2016 meeting of the Joint Legislative Oversight Committee on General Government.

Mr. Watts provided an update on the retirement amendments affecting the Division included in Senate Bill 886. Of particular interest were Sections 5 and 6. Section 5 requires the Board of Trustees to develop a State Contribution Rate Stabilization Policy for the Firefighters' and Rescue Squad Workers' Pension Fund, which will be reviewed in October and voted on in January 2017. Section 6 of the bill clarified responsibilities and authority for the Board. The statute change was recommended in advance of the transition to a new treasurer. Mr. Watts also reported on House Bill 960 – Retirement Creditable Service Charter Schools, House Bill 1011 – Retirement Technical Corrections Act of 2016, Senate Bill 865 – State Health Plan Changes, and House Bill 1080 – Achievement School Districts.

Mr. Thomas provided highlights of House Bill 1137, the Treasurer's 2016 Investment Administrative Changes Act, noting particularly Sections 3.2 and 3.4 of the bill. Section 3.2 expands the scope of oversight by the Investment Advisory Committee (IAC) to all funds managed by the Treasurer,

not just the Retirement Systems. The IAC meets quarterly providing advice to the Treasurer on legislative matters. Section 3.4 of the bill provides for the IAC to consult with the Treasurer and staff on certain key departmental ethics policies. The current Treasurer is directed to obtain feedback from the IAC and present the current or revised policies to the incoming Treasurer for adoption or re-adoption in 2017. The IAC will begin its review of policies in its September meeting.

Litigation Update

Bob Curran, from the NC Attorney General's Office, gave an update regarding recent litigation which has been filed since the last Board meeting. There were two complaints in Wake County, filed on behalf of four county boards of education, whose genesis was in the CBBC assessed employer contributions. The litigation was filed in May and in June. The Department moved to dismiss both complaints on the basis that the State and Board have sovereign immunity. Mr. Curran anticipates the motion to dismiss will be heard in September. Four petitions were filed in the Office of Administrative Hearings contesting the same issue. These have been consolidated and the Department has moved to dismiss these petitions as well. Mr. Curran said that the Board has authority to adopt actuarial factors and these are accessible to the public. These complaints do not involve personal liability of any Board members. There was a question about whether the four lawsuits were due to the pension spiking policy. Mr. Curran answered that the policy was established to capture unfunded liabilities regardless of how liabilities came about and that conversion of non-pensionable compensation into pensionable compensation could be a possible factor. The statute uses a formula based on the member's expected lifetime benefit to determine the CBBC liability. The statute initially provided that payment was due within 90 days of the member's retirement, but the statute has been amended to allow up to 1 year. The Board has the authority to notify the Office of State Budget and Management if an employer is delinquent, and OSBM would then intercept other state payments to the employer in order to recoup the payment amount. There was inquiry about whether employers were made aware of the payment obligation prior to a member's retirement. Mr. Toole stated that information is sent to the employers to notify of potential obligations if their employees retire in the next 12 months.

Secondary Employment Update

Mr. Thomas provided an update about an issue raised by Board members regarding secondary employment. He said that since the last Board meeting in April, the Department was approached by Mr. Aneralla and Mr. Mebane expressing concern about the principle of any State Treasurer serving on commercial corporate boards, given the nature of the Treasurer's obligations in office. Mr. Thomas stated that Mr. Aneralla and Mr. Mebane met with Treasurer Cowell on June 14 and had a good discussion. Treasurer Cowell expressed her interest in having any new policies in these areas treat the same all similarly situated personnel across state government. Mr. Aneralla and Mr. Mebane had requested that the issue be raised at the July TSERS/LGERS Boards of Trustees meeting. Mr. Thomas stated that he believed there was consensus among everyone in the discussion in favor of having staff study the issue, raise these points again at the next Investment Advisory Committee meeting, and then have a set of concrete proposals be presented at the September IAC meeting and the October TSERS/LGERS Boards of Trustees meeting.

Mr. Aneralla stated that he was surprised to learn that all State officials may seek outside employment. He would like the Board to determine what is appropriate for the future. Mr. Mebane made a statement to the Board. He said that during the term of the next Treasurer, the Retirement System will

face a number of critical issues. The issue of supplemental employment by the Treasurer is not a material issue, but one that needs to be addressed. He said that he does not think there is a looming ethics breach, but that the matter boils down to a difference of opinion and an ill-advised choice. In his view, a strong stance and further action is required, either through the IAC, the Board of Trustees or both. He stated that the Board members must be comfortable that they are representing their 850,000 members fully and effectively, guarding their interests every day. In his opinion, the Board's credibility on significant issues is dependent on how they deal with small issues like supplemental employment. He stated that the entire retirement system model will be challenged during the terms of most of the Board members, and that the Board must demonstrate its independence and objectivity in order to maintain an effective seat at the table representing our members with relevance and diligence. He concluded that he looks forward to the Board's contribution to the establishment of guidelines and expectations for future Treasurers.

There was discussion about the IAC having the opportunity to develop a policy on this topic as part of the House Bill 1137 policy consultation process discussed earlier in the meeting. Mr. Thomas invited anyone on the Board who wanted to discuss this issue to call him.

2015 Retirement Readiness Results

Steve Toole, Director, introduced Michael McCann, Prudential Retirement.

Michael McCann presented the results from 2015 retirement readiness study. The 2015 Retirement Readiness result was 60.48%. He said that the Retirement Readiness score declined in 2015 primarily due to the supplemental plan's overall flat investment performance, the drop in score for the members with only a pension plan, a large portion of the membership receiving salary increases in 2015, and contribution increases not keeping pace with salary increases. He concluded the presentation with suggested next steps for increasing participation in the supplemental plans based on identifying their priorities, having Nearing Retirement and Enrollment Campaigns, and leveraging data to target messages to those not participating in a supplemental plan. Twenty percent of members are within 5 years of retirement. Prudential contacts those members close to retirement with retirement readiness scores below 80%. Only 50.16% of our members are on track to replace 80% of their income by age 62 if they are only in the pension plan. Conversely, over 74% of all members are on track to replace 80% of their income by age 62 if they are in both the pension and a supplemental plan. Prudential conducts annual saving campaigns, retirement camps, and enrollment campaigns.

Mr. Toole discussed the plan design features that could improve supplemental plan participation such as auto enrollment and auto escalation. However, this requires legislative action and several past efforts have not been successful. Some participants have approached the Department who are appreciative of the education that helped them to make the best decision for their retirement planning. He mentioned that the Department has the strategy, but needs plan design at the employer level. Mr. Mebane asked what percentage of pre-retirement income comes from the defined benefit plan. Mr. Toole said that the average is 55% for members with 30 years of employment. The Department wants retirees to be able to have a secure retirement and feels that this is critical to its mission.

CEM Benchmarking Report Presentation

The Chair recognized Bruce Hopkins from CEM Benchmarking to present the results from the Pension Administration Benchmarking study. Mr. Hopkins reported that there were 16 peers in the

custom peer group for the North Carolina benchmarking. He said that the total pension administration cost was \$23 per active member and annuitant. This was \$66 below the peer average of \$89 and among one of the lowest in CEM's global universe. Mr. Mebane asked what the \$23 includes. Mr. Hopkins answered that it includes everything except investment costs. Mr. Mebane asked if there was any chance of allocations from other state agencies affecting the comparison. Mr. Hopkins said that could be possible, but the costs are so low that CEM did not think it was having a significant impact. Mr. Hopkins also presented on cost trends, the cost model used, and reasons why the total cost was below the peer average. The total service score of 72 was below the peer median of 79. Mr. Hopkins presented examples of key service measures included in the service score. He listed several factors that would lead to potential improvements to the total service score. Mark Stohlman asked if the Department has similar benchmarking on investment costs. Mr. Thomas said he would get back to Mr. Stohlman with the specifics. Mr. Mebane mentioned that North Carolina achieves better investment returns than peers and that the General Assembly feels that the plan is well funded. Mr. Hopkins closed the presentation with key takeaways and an update on global trends.

Approval of Post-disability Benefit Increase for Disability Recipients Contingent on Granted Salary Increase for All Active Employees

It was moved by John Aneralla, seconded by Lou Ann Phillips, and carried unanimously that the approval of post-disability benefit increase for disability recipients contingent on granted salary increase for all active employees be approved.

Implementation of Agency Participation Procedures Act (S.L. 2015-168)

Nick Byrne, Policy, Planning and Compliance Director, and Michael Mebane, Committee Chair, reported on the implementation of the Agency Participation Procedures Act. Under previous state law, a new charter school could request entry no later than 30 days after the charter school's charter was executed by the necessary parties. Under the current law, if a school is in operation for less than one year, the charter school is granted provisional entry to TSERS. Provisional entrants may join the System on a full or non-provisional status after one year's time at which point the charter school would be required to submit an application which includes a financial review of the charter school, and a required acknowledgement of the estimated withdrawal liability to the school as part of the process for final approval by the Board of Trustees.. Mr. Mebane indicated that an audit would not be available before a decision would need to be made about approving a charter school for participation. If the charter school has been in operation for more than one year, the school must apply for participation and the Board must approve entry. It is important for charter school boards to fully understand their obligations. He further said that this process is a good place to start and the Board can reassess in a year or two. Charter schools are unique; and the Board has a vested interest in making a good decision since the plan has to assume the unfunded liability if the school fails. John Aneralla asked if a charter school were to go out of business before the trial period was up, would there be any money to intercept. Mr. Patterson asked about individual liability for board members of a charter School that closed and incurred a withdrawal liability. Mr. Byrne answered that the primary reason for the withdrawal liability acknowledgement was to make charter school board members aware of the financial obligations of participation in the System.

It was moved by Lou Ann Phillips, seconded by John Aneralla and carried unanimously that the approval of the application form for participation for charter schools desiring entry into TSERS be approved.

Public Comment

Mr. Flint Benson, State retiree and lobbyist for SEANC, commented on several items including secondary employment and COLAs.

State System Adjournment

There being no further business before the Board, adjournment was moved by John Aneralla, seconded by Sheriff Carson Smith, and the meeting was adjourned at 1:10 p.m., without objection.

CHAIR

SECRETARY