MINUTES
BOARD OF TRUSTEES OF THE
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, Indiana 46204

October 16, 2009

EXECUTIVE SESSION

An Executive session was held pursuant to Indiana Code 5-14-1.5-6.1 (b)(2)(C). As set forth in IC 5-14-1.5-6.1 (d) matters discussed during the executive session were limited to those set forth in IC 5-14-1.5-6.1 (b)(2)(C). No executive session action took place as a result of the executive session.

REGULAR SESSION

Board Members Present

Ken Cochran, Chair
Kevin Boehnlein, Vice Chair (present for a portion of the meeting as indicated)
Bob Welch
Cynthia Walsh
Ryan Kitchell (present for a portion of the meeting as indicated)
Matt Murphy

Board Members Absent

Others Present

Douglas Kryscio, Mercer Investment Consulting
Sarah Cole, Aksia
Doug Todd, McCready and Keene, Inc.
Richard Lenar, McCready and Keene, Inc.
Kyle Kappel, KPMG LLP
Tony Buffomante, KPMG LLP

PERF Staff Present

Terren Magid, Executive Director
Kathryn Cimera, General Counsel
Shawn Wischmeier, Chief Investment Officer
Steven Barley, Chief Operations Officer & Deputy Director
Todd Williams, Chief Financial Officer
Jeff Hutson, Director of Outreach & Communications
Josh Rabuck, Director of Fixed Income & Real Assets / Deputy CIO
Sandra Wilson, Executive Assistant
Jeri Mains, Legal Assistant
Matt Ackerman, Manager-Vendor Management Office
Dave Huffman, Deputy Director and Chief Technology Officer
Wisty Malone, Director of Internal Audit

Meeting called to order at 1:13 p.m. by Chairman Cochran.

I. Approval of Minutes from August 21, 2009

MOTION duly made and carried to approve the minutes from August 21, 2009 Board of Trustees meeting.

Proposed by: ***Bob Welch***
Seconded by: ***Cynthia Walsh***
Votes: ***3 in favor, 0 opposed, 2 abstentions***

II. New Business

- **Modernization Projects Update**

Mr. Kitchell arrived during the Modernization Projects Update.

Mr. Magid introduced Dave Huffman, Chief Technology Officer, to present an update on the Indiana Retirement Systems Modernization Project. Typically this review is done only on an annual basis and while the annual update was given in April, due to a great deal of activity since the last update, an additional update was warranted.

Mr. Huffman began the presentation with a project review. Mr. Huffman then discussed the current status of the following projects: Oracle, ACS Phase II, and Wage & Contribution.

Mr. Huffman explained that the Oracle Financial Systems should go-live on approximately November 1, 2009 and that the status of the Oracle Financial project looked good. Mr. Huffman then discussed the possibility of needing to move the go-live date for ACS Phase II to July 1, 2010. Reasons for moving the ACS Phase II go-live date include technology and data issues, and also an under estimation of the problems created with trying to develop one system for two plans. In addition there have been issues with PERF's third-party vendor. With respect to the wage and contribution systems, Mr. Huffman explained that this project started slowly but is now back on track. While the wage and contributions project is on schedule, staff is recommending the go-live date be moved to December 31, 2010 to avoid having the implementation of 2 systems so close together.

- **Investments**

<u>Investments Update</u>

Mr. Magid introduced Shawn Wischmeier, Chief Investment Officer, and Doug Kryscio of Mercer, to the Board to present the Investments Update. Mr. Kryscio provided the Board with a performance update as of September 30,

2009. Mr. Wischmeier followed with a discussion on Alternative Investments. There have been no new commitments in the private equity space since the Board's last update.

Absolute Risk Discussion

Mr. Wischmeier gave a brief introduction for the absolute risk discussion. Pursuant to the Board's request the Investments team has been presenting information on risk beginning with the discussion on relative risk in August. The November Board Meeting will conclude the presentations with a discussion on tail risk. Mr. Wischmeier introduced Josh Rabuck, Director of Absolute Return and Risk Management, to the Board. Mr. Rabuck gave a summary overview of absolute risk. Mr. Rabuck discussed PERF's asset allocation and how that is used to control the volatility of the Fund's assets as measured by the standard deviation of returns.

Absolute Return Update

Mr. Wischmeier then introduced Sarah Cole with Aksia. Ms. Cole presented an update on PERF's absolute return portfolio. Ms. Cole discussed the progress made at PERF with the portfolio and also provided a background discussion of the state of the absolute return industry this past year.

Ms. Cole further discussed management fees and how fees were affected by the liquidity crisis and what is expected from the industry on a going forward basis. Ms. Cole reviewed the work PERF and Aksia performed with respect to researching managers, and also outlined the performance of PERF's portfolio to date.

- **Finance & Budget**

Financial Update

Mr. Todd Williams, Chief Financial Officer, reviewed the September financial statements with the Board. As of September 30, 2009, Mr. Williams reported that the net assets of approximately $13.8B improved 11% from June 30, 2009, but had declined approximately $331 million over the last 12 months due to investment performance. Cash and cash equivalents increased by $4 million over the prior year.

Specific items noted by Mr. Williams included that in FY 2010 PERF will invoice TRF for $7 million pursuant to the cost sharing agreement wherein TRF agreed to share costs for IT services provided to TRF by PERF. Mr. Williams further noted that investments had declined 2% for the one year period, and total net assets had declined about 2%.

Mr. Williams also discussed the Statement of Expenditures as of September 30, 2009. He pointed out the year-to-date total administrative expenses are $4.5 million below the budget that PERF had in place for the same period last year.

- **Pension Sustainability**

Mr. Magid introduced Doug Todd from McCready and Keene to the Board. Mr. Magid discussed the current state of the public pension industry and where PERF sits relative to other public plans in the industry.

Mr. Magid reviewed a summary presentation from a survey representing 101 state and local government pension funds conducted by NASRA, the National Association of State Retirement Administrators. The presentation included information on funding levels, expected contribution rates, membership changes, and other data that feed actuarial analyses. Some of the highlights included the following:

Mr. Magid reviewed the aggregated funding levels of public plans. Most plans rode up through the tech bubble but have been riding it down ever since. As of the fiscal year ending 2008, PERF's aggregate funding level was at 97.5%, well in excess of the aggregate funding levels of the public plans in the survey which was 85.3%.

In 2008, the median employee contribution rate in 2008 for public plans where social security is available was 5%, and the median employer contribution rate was 8.6%. By comparison, in 2009 PERF's state employee contribution rate was 3% and its state employer contribution rate was 6.5%. In addition, while most of the plans surveyed had negative cash flows, PERF's cash flow was positive. Mr. Magid further discussed how PERF compared to other plans with respect to its asset allocation and its use of smoothing periods. Lastly Mr. Magid summarized with some NASRA observations about the public pension industry currently, and for the coming year.

Mr. Todd then discussed PERF-specific information relating to historical investment results, funding status and projected contribution rates. Mr. Todd presented a historical comparison of PERF's assumed rate of return, market return and actuarial return for the past ten years. PERF's actuarial return over the last ten years was less volatile then the market return.

Mr. Todd then discussed PERF's funded status as of July 1, 2008. PERF's funded status as of July 1, 2008 was 97.5%. A contributing factor to PERF's high funded status is that cost of living adjustments are passed by the General Assembly on an ad hoc basis. Because a 1.5% COLA assumption is assumed in the actuarial valuation, there is an experience gain realized by the plan anytime the legislature does not pass a COLA, or passes a COLA which amounts to less than the impact of the 1.5% assumption. Lastly Mr. Todd noted that if actual investment returns are at the assumed rate of 7.25%, state employer contribution rates are expected to increase gradually over the next several years to as high as 11% by 2013. All else equal, if PERF earns actual returns in excess of the assumed rate of 7.25 the contribution rates likely will not increase as great.

Mr. Boehnlein left after the Pension Sustainability presentation.

III. Executive Director Report

Mr. Magid discussed scorecard results, Q1 accomplishments, Q2 goals and Q2 challenges.

On the scorecard, Mr. Magid focused on the fundamental PERF Change Initiatives Section-Institutionalizing Operation Excellence & Customer Service Enhancements. Mr. Magid also discussed Q1 accomplishments including the State Board of Accounts' Audit. PERF received a clean audit opinion with no findings, a first in PERF history based on comments from the SBOA. Mr. Magid discussed the accomplishments of the Employee Retention Committee, an ad hoc committee created to develop ideas to award and recognize PERF employees in light of the budget constrained environment. The committee developed an employee appreciation week and recommended an alternative work schedule which has been launched on a trial basis.

Mr. Magid discussed Q2 goals including, but not limited to, the following: launching a new financial system, reworking the ASA (Phase II) Project Plan, identifying new ASA Fund Managers, completing an IT Security Audit, Internal Audit Risk Assessment, and developing the 2010 Audit Plan.

Mr. Magid also discussed Q2 challenges which include the strategic hiring process that was implemented by the State of Indiana in November 2008. Mr. Magid explained that the state modified its hiring practices with a goal to maintain a balanced budget. However, because PERF's operating budget is funded out of trust assets, personnel costs have virtually no impact on the state budget. The new hiring process impacts PERF because PERF utilizes the state's payroll system and PERF cannot pay its employees without first receiving approval from the state's hiring committee to obtain an ID number from the state's auditor. As a result, PERF is required to go through the state's hiring committee for approval.

Recently PERF was denied approval for several key positions. While PERF continues to take steps to mitigate the impact of open positions, if PERF continues to be unable to fill necessary positions PERF's performance against its customer metrics may begin to suffer and ongoing projects may be subject to additional risks to successful execution. Different options for addressing this problem were discussed. PERF could fill positions on a contract basis but this method would increase expenses versus budget and potentially lead to higher turnover. It was suggested PERF could work with the hiring committee and offer to eliminate non-essential positions in order to fill essential positions. Alternatively, PERF could outsource payroll and benefits so PERF would not be dependent on the state's systems. While no definitive resolution was reached, the Board agreed that staff make an additional attempt to work with the hiring committee.

Finally, Mr. Magid gave each member a list of potential agenda topics previously submitted by board members and asked them to select their top three to be included in the November Annual meeting.

IV. Date of Next Meetings

November 20, 2009 Annual Meeting

V. Adjourn

The meeting adjourned at 4:35 p.m.