

**MINUTES
BOARD OF TRUSTEES OF THE
INDIANA PUBLIC RETIREMENT SYSTEM**

**Meeting held at:
One North Capitol
1st Floor Conference Room
Indianapolis, Indiana 46204**

September 14, 2012

Board Members Present

Greg Hahn, Vice Chairman
Tim Berry
Jodi Golden
Adam Horst
Michael Pinkham
Bret Swanson
Cari Whicker

Others Present

Michael Long, Cortex Applied Research
Bruce Hopkins, CEM Benchmarking
Michael McGarry, Protiviti
Jim DeLoach, Protiviti
Keith Kotfica, Xerox
Amanda Black, Capital Cities
Janet Sweet, Capital Cities
Pete Keliuotis, Strategic Investment Solutions (SIS)
Rich Dabrowski, Strategic Investment Solutions (SIS)
Ray Jones, IRTA

Staff Present

Steve Russo, Executive Director
Andrea Unzicker, Chief Legal & Compliance Officer
Donna Grotz, Director of Strategic Initiatives and Administration
Julia Pogue, Chief Financial Officer
Jeff Hutson, Chief Communication Officer
Teresa Snedigar, Director of Internal Audit
Steven Barley, Chief Operations Officer & Deputy Director
Mike Hinline, Chief Information and Technology Officer
David Cooper, Chief Investment Officer
Allison Karns, Legislative Director
Dan Guingrich, Enterprise Risk Manager

Scott Davis, Investments, Director of Public Equity
Erin Hankins, Executive Assistant
Katie Williams, Legal Analyst

Meeting called to order at 9:03 a.m. by Vice Chairman Hahn.

I. Board Education

A. Governance

Steve Russo gave an overview the topics to be covered during the education portion of the meeting and the commitment that was made to minimum yearly education hours for the INPRS Board of Trustees. Mr. Russo introduced Michael Long, from Cortex, gave some background on Cortex, and reviewed their report of INPRS' governance practices.

Mr. Long gave a presentation on governance to the Board. He highlighted obligations of the board and their fiduciary duty to the fund. He described the job of a pension fund trustee with five key functions: (1) set direction, (2) set constraints and parameters, (3) determine organizational infrastructure, (4) key appointments, and (5) monitor and evaluate organizational performance. Mr. Long then discussed Governance Best Practices and Benchmarking Data. He defined best practices and described Cortex's approach to benchmarking best practices. He presented standards and peer group data for several areas of governance practices: board composition, board committees, governing authority, delegation framework, ethics policies, board education, planning, risk management, and communication and disclosure.

B. Enterprise Risk Management

Mr. Russo introduced Jim DeLoach, from Protiviti, to educate the Board on the topic of Leading Practices in Enterprise Risk Management. Mr. DeLoach described the current state of enterprise risk management and the role of enterprise risk management in decision making and planning. He reviewed the leading practices and offered six key insights into enterprise risk management—how companies successfully implement ERM and the benefits of such a program. Mr. DeLoach shared lessons learned as ERM is implemented by more companies. He discussed three stages of building ERM capabilities and factors that companies should consider when implementing an ERM program.

C. Benefits Administration & Stakeholder Communication

Mr. Russo introduced Bruce Hopkins from CEM Benchmarking Inc. to present to the Board on the topic of Pension Fund Administration Best Practices. Mr.

Hopkins began with an overview of CEM Benchmarking Inc and described their approach to finding best practices. He compared INPRS to similar funds, looking at service at the activity level, and reviewed best practices by activity. Mr. Hopkins offered benefits of surveying, practices to maximize benefits of surveying, and survey features that maximize benefits.

D. DC Plan Administration

Mr. Russo introduced Keith Kotfica, from Xerox, to present to the Board on the topic of Defined Contribution Trends. Mr. Kotfica began by summarizing the core Defined Contribution Plan elements for a changing workforce. He discussed the importance of improving member self-service and ideas for modernization. He described the principles that Xerox uses to drive improvement and accuracy in the area of information quality when processing forms and data changes. Mr. Kotfica described the effect of certain regulations on pension funds. He concluded his presentation with a discussion of the future of DC plans.

II. Approval of Minutes from June 29, 2012 Board of Trustees Meeting

MOTION duly made and carried to approve the minutes from the June 29, 2012 Board meeting.

Proposed by: Bret Swanson
Seconded by: Adam Horst
Votes: 6 in favor, 0 opposed, 0 abstentions

III. Committee Reports

A. Investment Committee

Bret Swanson presented the INPRS Investment Committee report to the Board. On August 29, 2012, the committee met and discussed the following topics: department update, compliance, securities lending, commission recapture, new commitments (private equity, hedge funds, and real estate), major actuarial valuation assumptions and methods, IIF2 update, private equity strategy update, commodities review, performance review, risk management update, and 2012 objectives.

B. Audit and Risk Committee

Adam Horst presented the INPRS Audit and Risk Committee report to the Board. On September 6, 2012, the committee met and discussed the following topics: review of the committee charter, ERM process and risk assessment; results of the FY12 internal audits (review of findings and status of remediation plans), and the FY13 audit plan (review of auditable units at INPRS, review of risk assessment process, and review of audit plan by quarter).

IV. Required Business

In accordance with normal practice, written materials for the following matters were provided to the Board members by mail in advance of the meeting.

A. Adoption of Indiana Administrative Code

Allison Karns presented proposed updates to the Indiana Administrative Code. The changes were grouped in three categories: (1) Incentive Compensation Plan (35 IAC 1.2-5-5; 35 IAC 14-2-10); (2) Actuarial Equivalence Assumptions (35 IAC 1.2-8-5; 35 IAC 1.3-10-1; 35 IAC 14-2-16); and (3) Section 401(h) Medical Benefits Accounts Rules (35 IAC 20). A written Executive Summary of these changes was given to the Board for review.

MOTION duly made and carried to adopt the staff recommended changes to the Indiana Administrative Code as captured in Resolution No. 2012-9-01.

Proposed by: Adam Horst
Seconded by: Bret Swanson
Votes: 6 in favor, 0 opposed, 0 abstentions

B. Board Governance Manual Update

Andrea Unzicker presented an updated version of the Board Governance Manual to the Board for their approval. Proposed changes were reviewed by the Board previously on April 27 and June 29, 2012. The only revision made to the draft since the June 29, 2012 review is an acknowledgement of the newly-adopted assumed rate of return of 6.75% in the Risk Appetite. A high-level summary of all changes to the Board Governance Manual and a copy of the complete document were provided to the Board. Ms. Unzicker confirmed that the new version would be posted on the INPRS website upon approval.

MOTION duly made and carried to approve the new version of the Board Governance Manual.

Proposed by: Jodi Golden
Seconded by: Bret Swanson
Votes: 6 in favor, 0 opposed, 0 abstentions

C. FY13 Audit Plan

Teresa Snedigar presented the Fiscal Year 2013 Audit Plan to the Board for their approval. The details of the plan were reviewed by the Board in the June 29, 2012 meeting and the plan was ready for approval. Ms. Snedigar stated that the audit staff will continue to evaluate the plan throughout the implementation. If any changes are made to the plan, they will be brought to the Board for approval.

MOTION duly made and carried to approve the Fiscal Year 2013 Audit Plan.

Proposed by: Tim Berry
Seconded by: Adam Horst
Votes: 6 in favor, 0 opposed, 0 abstentions

V. Unfinished Business

A. Actuarial Factors

Julia Pogue presented an update to the Board on the topic of Actuarial Factors for Calculating Member Benefit Payments. The topic was discussed in depth in the committee meeting. Mr. Russo summarized the difference between factors and assumptions. Ms. Pogue stated that INPRS is considering changing factors because assumptions have been changed. She gave an overview of actuarial factors, their function, and their role in calculation of member benefits. Interest Rate assumptions and Mortality assumptions play key roles in determining the magnitude of the actuarial equivalence factors. Ms. Pogue described recent changes to actuarial factors in the private and public sectors. She explained the reasons for reviewing factors at this time.

Ms. Pogue presented three options that are under consideration and the potential results of each option. The first option is “do nothing”, which is permissible by Indiana law, is consistent with ERISA and most other public plans, and adds cost and risk to the employer. The second option is to “match actuarial assumptions for both DB benefit options and ASA annuities”, which aligns projected income streams to payment streams and generally lowers a member’s benefit. A board member asked about the effect on administrative costs with this option. Ms. Pogue replied that there would be increased costs initially. The third option is to “match actuarial assumptions for DB benefit option and establish separate ASA annuity strategy”, which, depending upon the strategy employed, reduces or eliminates risk to the employer and lowers the member’s annuity payment by approximately 8% for each 1% reduction in the interest rate.

The next steps are: (1) complete further actuarial analysis to better understand the financial impact of each option; (2) better understand options and investment strategies available for ASA annuities by issuing a third-party Request for Information (RFI); and (3) continue discussions with the Investment & Actuarial committee.

A discussion was had among board members and staff about the importance of reviewing actuarial factors and how often factors have been and will be changed. Ms. Pogue stated that INPRS has changed actuarial assumptions twice since 2010. Mr. Russo stated that the average rate of change for pension plans is every five years. Board member stated that this is an area of risk for INPRS and the state government.

B. Guaranteed Fund Study

Mr. Russo introduced the topic and gave background of the issue. Amanda Black and Janet Sweet from Capital Cities (CapCities) presented a summary of the Guaranteed Fund (“GF”) Project to the Board. Ms. Black began with an overview of the project. She reviewed a timeline, the history, and the statutory framework for the GF. Ms. Black explained the methodology and history of the crediting rate; described the market environment for “guaranteed” funds; and discussed the trend of decreasing returns across fixed income styles. She reviewed the role of the GF in the ASA plan and the level of utilization of INPRS participants in the GF. Ms. Black then presented industry benchmarks and remarked that no other public entity offers an option where it serves as the “guarantor” aside from the Federal government.

Ms. Black offered possible solutions that would maintain the State’s position as “guarantor”. The first option is to “Maintain the Guaranteed Fund”. The second option is to “Amend the Guaranteed Fund” by (1) clarifying statutory language; (2) changing the crediting rate methodology; (3) changing structure and timing of the guarantee; and/or (4) changing the law to force a change in participant utilization through re-enrollment. A board member asked if members have responded to the credit rate change. Staff replied that there has not been much response. The third option, presented by Ms. Black, is to “Eliminate the Guaranteed Fund” and offer a Custom Stable Value Fund, a Money Market Fund, or a Short-Term Bond Fund. She provided pros and cons for each sub-option.

Then, Ms. Black summarized INPRS current state position and change options. She expressed that INPRS is fulfilling its fiduciary duty and acting within all applicable state laws and that recent improvements in the ASA plans reflect the highest standard of fiduciary oversight. She presented a flow chart to indicate decision making factors should INPRS pursue alternatives to the current state.

A discussion was had on the various options presented. Board members discussed potential opposition to removing the GF, the level of engagement by members in their investment options, and that GF members are generally resistant to change. A suggestion was made to begin the process of making legislative changes for the purpose of clarifying language to better define the GF. Staff and board members agreed that this would be beneficial, but would take time and effort to educate legislators on the issue. Mr. Cooper suggested that all would benefit from more information about the Custom Stable Value Fund option and process. Board member suggested engaging the legislature in a discussion of changing the language in the Indiana Code surrounding the GF.

MOTION duly made and carried to take a discussion of clarifying and/or changing Guaranteed Fund language in the Indiana Code to members of legislature.

Proposed by: Adam Horst

Seconded by: Jodi Golden
Votes: 7 in favor, 0 opposed, 0 abstentions

VI. New Business

A. Financial Update

Julia Pogue presented the INPRS financial update to the Board. This update included financial highlights as of June 2012. She summarized the Fiscal Year 2013 forecasted net position compared to the budget for four specific areas: administration, projects, investments, and capital. Ms. Pogue gave an overview of the INPRS FY2013 annual change in net position forecast and stated that this is the first time Finance is preparing an income statement annual forecast. She reviewed the major assumptions impacting the forecast and compared the FY13 annual forecast to the FY12 actuals. Ms. Pogue stated that the forecast will be reviewed quarterly. Board member expressed support of forecasting.

B. Investments Update

David Cooper and Pete Keliuotis, from Strategic Investment Solutions (SIS) presented the investment update to the Board. Mr. Cooper began with a review of the INPRS portfolio and the peak to trough performance. Mr. Cooper presented the INPRS asset allocation: actual and target. He commended his staff on the great work done on asset allocation and the benefits of adding risk parity.

Mr. Cooper reviewed the FY12 performance by comparing asset class contribution to total return first within each quarter and then over the entire year. A board member asked how INPRS compares with other plans. Mr. Cooper replied that INPRS is in good shape among its peers. Mr. Cooper compared the excess return attribution by economic environment for actual and target allocation for FY12. A board member asked about INPRS target allocation compared to peers. Staff stated that if INPRS had started the last fiscal year with the new asset allocation, the fund would have been fourth best out of 34 peer funds in FY12.

In summarizing the DB Performance, Mr. Cooper stated that INPRS was able to meet benchmarks despite changes in the market. He compared the rates of return for private equity and private real estate, gave an update on risk parity performance, and summarized the ASA performance of PERF and TRF funds. Mr. Cooper reviewed the list of recent investments and terminations. He stated that the Investment Committee had an in depth discussion of recent new investments and terminations. Mr. Cooper gave an update on the Watch List and said that an RFP is needed for a new mid-cap manager.

C. Indiana Investment Fund II (IIF2)

Mr. Cooper gave an update on the various Indiana investment programs to the

Board. He provided an overview of the Indiana Investment Fund II (“IIF2”) and steps that have been taken recently. Mr. Cooper described two potential investment firms to manage IIF2: Carlyle Group and Customized Fund Investment Group (CFIG). Either manager would significantly reduce comparable management fees being paid for IIF2 versus those being paid for IIF1. IIF2 will invest in Indiana Partnerships and companies that are (1) based in Indiana, (2) are planning to move some or all operations to Indiana, or (3) have a nexus of activity or some meaningful connection to Indiana. There is a need for a formal Request for Proposal process to select a manager for IIF2. A board member asked how long the RFP process would take. Mr. Cooper replied that he expected the RFP process to be completed by October 31, 2012. Mr. Keliotis added that his company has done a similar RFP process recently and is confident that it can be completed quickly. A board member expressed support for the RFP process and the development of IIF2.

MOTION duly made and carried to approve the staff recommendation for consultant SIS to conduct a formal RFP and to provide recommendation to staff and board for Indiana Investment Fund II.

Proposed by: Jodi Golden
Seconded by: Tim Berry
Votes: 7 in favor, 0 opposed, 0 abstentions

D. Executive Director’s Report

Steve Russo presented the Executive Director’s report. He began with an update on the Pension Management Oversight Committee (PMOC). Mr. Russo gave an update on INPRS to PMOC on August 14, 2012. A copy of the presentation is available on the INPRS website. Mr. Russo reviewed the topics that were studied in summer study committee. One topic studied was local pension plan data reporting and the outcome of the study is that PMOC will recommend to the legislature that the responsibility for collecting this data be moved to the State Board of Accounts (SBOA). Another topic discussed at PMOC was member benefits: COLAs, one-time checks, and minimum benefit. There was also discussion of benefit alignment between PARF and Judges. Mr. Russo summarized code changes that were requested by INPRS at PMOC: ASA-only plan clarifications, INPRS Board Officer Election timeframe, and PERF/TRF plan alignment.

Mr. Russo then discussed the rating agency Moody’s and their recently issued Request for Comment on proposed adjustments to reported pension plan data. Mr. Russo summarized Moody’s proposed changes and stated that, if implemented, these changes would greatly increase reported unfunded liabilities and calculated annual pension contributions. He stated that INPRS has identified errors in Moody’s preliminary analysis of INPRS’ data. Any comments to Moody’s are due September 30, 2012.

Mr. Russo stated that INPRS staff has been evaluating electronic board portals to increase board efficiency and communications. BoardEffect was determined to be the most cost-effective solution for INPRS' needs. A BoardEffect representative gave a virtual demonstration of the tool to the Board. A discussion was had among board members about the benefits and usefulness of using an online portal. Members gave positive feedback about the BoardEffect portal.

Mr. Russo highlighted INPRS' recent media coverage. Main areas of coverage were: lowering of investment return assumption, FY12 investment performance, and asset allocation and investment management fees. He stated that INPRS has media monitoring tools in place.

Mr. Russo updated the Board on the ongoing modernization efforts. The Employer Reporting & Maintenance (ERM) project is on track to go-live in October 2012. He discussed the status of application and employer readiness. Mr. Russo described the contingency plans and processes that are in place. A board member asked about the timeliness of employer reporting. Mr. Russo replied that most employers are on time each quarter and efforts are being made to assist those who struggle. The new Defined Benefit system (INPAS) project remains on track.

Mr. Russo presented metrics highlights for the Governor's and Board Dashboards. Retirement processing and customer satisfaction remain in the green.

E. Other Business

Jodi Golden expressed gratitude for the opportunity she had to attend a board education conference.

The date of the next board meeting will be November 2, 2012.

VII. Adjournment

MOTION duly made and carried to adjourn the September 14, 2012 Board meeting at 2:32 p.m.

Proposed by: Adam Horst
Seconded by: Cari Whicker
Votes: 7 in favor, 0 opposed, 0 abstentions