MINUTES
BOARD OF TRUSTEES OF THE
INDIANA PUBLIC RETIREMENT SYSTEM

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

June 29, 2012

Board Members Present
Ken Cochran, Chairman
Tim Berry
Adam Horst
Michael Pinkham
Bret Swanson
Cari Whicker

Others Present
Rich Dabrowski, Strategic Investment Solutions (SIS)
Joe Bill Wiley, Capital Cities
Amanda Black, Capital Cities
John Dowell, Nyhart
Mike Zurick, Nyhart
Andy Thomas, IRTA

Staff Present
Steve Russo, Executive Director
Erin Hankins, Executive Assistant
Andrea Unzicker, Chief Legal & Compliance Officer
Katie Williams, Legal Analyst
Donna Grotz, Director of Strategic Initiatives and Administration
Julia Pogue, Chief Financial Officer
Teresa Snedigar, Director of Internal Audit
Keith Hall, Internal Auditor
Beth Meyer, Sr. Internal Auditor
Katrina Farley, Internal Auditor
David Cooper, Chief Investment Officer
Bo Ramsey, Senior Investment Analyst
Scott Davis, Director of Public Equities
Stephanie Anderson, Investment Analyst

Meeting called to order at 10:01 a.m. by Chairman Cochran.

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

I. Approval of Minutes from April 27, 2012 Board of Trustees Meeting

MOTION duly made and carried to approve the minutes from the April 27, 2012 Board meeting.

Proposed by: ***Tim Berry***
Seconded by: ***Mike Pinkham***
Votes: ***6 in favor, 0 opposed, 0 abstentions***

II. Committee Reports

Bret Swanson presented the INPRS Investment Committee Report based on their June 19, 2012 meeting. A memo given to the Board listed topics discussed in the meeting. Mr. Swanson gave a brief summary of their discussion regarding compliance, sec lending, and private equity strategy.

III. Required Business

A. Adoption of Indiana Administrative Code

Andrea Unzicker presented proposed updates to the Indiana Administrative Code. The changes were grouped in three categories: Definitions (35 IAC 1.2-2-1; 35 IAC 14-2-10), Special management teams/Turnaround academies (35 IAC 1.2-3-3; 35 IAC 14-4-1), and Alignment with Internal Revenue Code (35 IAC 8-1-1; 35 IAC 8-2-1; 35 IAC 16-1-1). 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. 2012-6-01.

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

B. Board Governance Manual Update

Ms. Unzicker introduced the topic and stated that no vote would be taken regarding the Board Governance Manual (BGM) so that it could be considered for a vote at the September meeting. Steve Russo began the discussion of Board Governance Manual ("BGM") updates by explaining the development process of the INPRS Strategic Plan and Vision Statement, as well as its addition to the BGM. Ms. Unzicker reviewed the revised committee structure and the duties of each committee as included in the updated BGM. Mr. Russo discussed the importance of Board committee development and the value of more in depth discussion of topics outside of the regular Board meetings. Ms. Unzicker reviewed the addition of various Board Retained and Delegated duties, as well as duties delegated to staff, to the BGM appendix. Several technical corrections were made to the BGM based on language in the Indiana and/or for clarification. Chairman Cochran suggested that each Board member review the updated BGM in order to discuss and adopt (if agreed) at the next Board meeting. Board member offered support of the proposed structure of the Board committees and development plan.

C. Strategic Plan Approval

Mr. Russo introduced Donna Grotz to present the Strategic Plan update. Ms. Grotz gave an overview of the plan and recent updates. FY12 was rolled off, while FY15 was rolled on to the plan. The introduction section was enhanced to include the recently identified Top 5 Goals for INPRS, alignment between Strategic Planning and Enterprise Risk Management, and the Risk Assessment process. The INPRS Vision statement was also added to the Strategic Plan. In order to improve the identification of metrics from goals and objectives, detailed metrics were not included in the Strategic Plan. However, objectives to improve or maintain excellence of metrics were included. Management of the Strategic Plan will include: monthly updates of metrics and Strategic Plan status, the development of additional metrics, and the identification of Key Risk Indicators. A copy of the updated INPRS Strategic Plan was given to the Board for review.

MOTION duly made and carried to adopt the staff recommended INPRS Strategic Plan for the period of June 29, 2012 – June 30, 2015.

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

D. New Units and Enlargements

Julia Pogue presented New Units and Enlargements to the Board. Five (5) new units were proposing to join PERF, which would result in 22 total new positions and 29 total new members. Five (5) current units were proposing additional coverage, which would result in 12 total new positions and 67 total new members. The enlargements would stay at the current contribution rate. Ms. Pogue proposed to the Board that the new units join PERF and make contributions based on a composite employer rate. A brief discussion was held on the current number of employers contributing at the composite rate.

MOTION duly made and carried to adopt the staff recommended Resolution No. 2012-06-02 to provide that all new political subdivisions joining PERF pursuant to IC 5-10.3-6 shall be in the Composite Rate Group.

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

E. FY13 Budget Approval

Ms. Pogue presented the Fiscal Year 2013 Budget to the Board. The FY13 Budget was reviewed in the April 2012 Board meeting. No changes were made to the budget since that time. Ms. Pogue provided a chart showing budget history as requested by the Board in April. Details of major expenses from 2008 through 2014 were presented on an expense timeline. Mr. Russo explained the process of creating the timeline and that INPRS has been compared to other plans. Board members asked about anticipated one-time expenses in the future. Mr. Russo stated that INPRS plan to put more adaptable and flexible modernization programs in place that would keep future expenses lower.

MOTION duly made and carried to adopt the staff recommended Fiscal Year 2013 Budget of $36.3m Administrative Expense, $14.9m Project Expense, $175.9m Investment Expense, and $7.2m Capital.

Proposed by: ***Bret Swanson***
Seconded by: ***Mike Pinkham***
Votes: ***6 in favor, 0 opposed, 0 abstentions***

F. TRF Actuarial Experience Study

Ms. Pogue introduced John Dowell and Mike Zurick from Nyhart to present their findings from the TRF Actuarial Assumptions Study. Mr. Dowell began with a summary of the study and an overview of results. The objective of the study was to measure recent experience of the Indiana State Teachers' Retirement Fund and recommend new actuarial assumptions for the June 30, 2012 actuarial valuation based on that experience. The study was based on changes in the census data used in the 6/30/2007 through 6/30/2011 actuarial valuations, with some consideration to the period 6/30/2002 through 6/30/2007. The experience study focused on the following areas: annual pay increases, rates of retirement, rates of withdrawal, and rates of mortality. Mr. Dowell noted that other key assumptions (annual investment return and annual COLA) are policy-driven versus experience-driven and are reviewed outside of the scope of the study.

In presenting the overview of results, Mr. Dowell stated that the experience study confirmed that the nature and types of assumptions used in prior valuations are still appropriate. However, minor modifications were recommended for all current assumptions. In the area of annual pay increases, Nyhart recommended that the 2012 inflation component remained unchanged at 3.0% and that the 2012 merit component be reduced at all service levels to yield a total weighted-average annual increase (inflation + merit) of 4.79%. Regarding rates of retirement, the recommended 2012 retirement assumption modifies the current assumption table to assume fewer reduced retirements at ages 55-59 to correspond to recent experience. The revised assumed age at retirement is 59.8, which matches recent experience.

The result of the study of rates of withdrawal is a recommended 2012 withdrawal assumption that is very similar to the current assumption, with slightly higher overall withdrawal rates after 10 years of service than the current assumption.

The recommended 2012 mortality assumption projects the current IRS table an additional five years, to the year 2018. The observed morality experience was in line with or slightly better (fewer deaths) than the recommended 2012 assumption.

Mr. Dowell presented the estimated fiscal impact of these proposed modifications on the TRF Pre-1996 and 1996 Accounts in the areas of Funded Percentage and Unfunded Liability. The Mortality Assumption has the greatest impact of change on the liability of the Pre-96 Account, while the Pay Increase Assumptions has the greatest impact of change on the 1996 Account.

Ms. Pogue presented the INPRS staff recommendation:

INPRS staff recommended changing the following four (4) actuarial assumptions for the TRF actuarial valuation as of June 30, 2012, based on the TRF Actuarial Experience Study:

1) *Annual Pay Increases – wtd. avg. of 4.79%*
2) *Rates of Retirement – avg. age of 59.8 yrs.*
3) *Rates of Withdrawal – similar to current rates*
4) *Rates of Mortality – 2013 IRS table with additional 5 yrs.*

Mr. Russo asked whether the recommended assumptions were considered conservative. Mr. Dowell replied that, as a group, the assumptions are still conservative. He mentioned that the COLA assumption significantly affects the overall cost and is, on its own, very conservative.

Board member asked how Indiana compared with Nyhart clients in other states. Mr. Dowell replied that Indiana is similar and may be slightly more conservative.

MOTION duly made and carried to adopt the staff recommended changes to the actuarial assumptions for the TRF actuarial valuation as of June 30, 2012 as summarized above.

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

G. Actuarial Assumptions & Factors

- Major Actuarial Valuation Assumptions and Methods

Ms. Pogue introduced the topics for discussion and outlined the plan for the completion of the yearly Actuarial Report. Finance has developed an Actuarial Policy that will be included in the Board Governance Manual and presented to the Board in the September meeting. Valuations are being discussed at the June meeting in order to complete the Actuarial Valuation Report earlier, so that actuarial information is on the same fiscal year as financial information and improve the CAFR.

Ms. Pogue gave an overview of the major actuarial assumptions and methods for the Defined Benefit retirement plans' actuarial valuations as of June 30, 2012. She reviewed the history of Cost of Living Adjustment (COLA) and 13th Check Payments for PERF and TRF and the current COLA actuarial assumptions. Staff recommended there be no changes to COLA assumptions.

Staff recommended that no changes be made to Inflation and Future Salary Increases assumptions, except to change TRF Future Salary Increases assumption to 3.0% to 12.5% based on the experience study.

A new mortality table is available. Staff recommended that INPRS begin using the 2013 IRS Static Table Projected Forward 5 Years to 2018, which would be consistent with the TRF 4-Year Experience Study.

Ms. Pogue reviewed the Actuarial Cost Method, the Asset Valuation Method (Actuarial Value of Assets), and the Amortization Method/Period. Staff recommended that no changes be made to Actuarial Methods.

- Interest Rate / Investment Return Actuarial Assumption

Ms. Pogue introduced the topic and provided background on interest rate / investment return assumption process and purpose as it relates to the industry and INPRS. For INPRS actuarial valuation purposes, the interest rate / investment return assumption used for computing the actuarial liability is currently set equal to the long-term expected return on assets for all INPRS Defined Benefit retirement plans. It is a long-term assumption that typically only changes when: (1) the long-term view of the market changes, or (2) the investment allocation changes. As approved by the PERF and TRF Boards in September 2010, the current interest rate / investment return assumption is 7.0%. Assumptions for both PERF and TRF were reduced from 7.25% and 7.50%, respectively to 7.0% at that time.

Ms. Pogue presented charts from the NASRA Public Fund Survey showing the Distribution of Investment Return Assumptions and Changes in Investment

Return Assumptions Used by Large Public Plans. She discussed INPRS' position compared to other plans. Mr. Russo commented on the industry trend of reducing assumption rates. Ms. Pogue reviewed the median contribution rates used by large public plans. She then compared an interest rate / investment return assumption that is set too low with one set too high and the effects on pension liabilities, short-term funding requirements, current taxpayers, and future taxpayers.

Ms. Pogue transitioned the presentation to Investments for a discussion of System Return Expectations.

David Cooper introduced Rich Dabrowski from SIS. Mr. Dabrowski discussed historic SIS expectations (from 1994 to the present) and INPRS return expectations (comparing May 2011 and May 2012) for individual asset classes. Mr. Cooper presented a chart showing the risk free rate decline and explained the significance of the yield curve in determining how assets are priced. The trend of the risk free rate suggests that, all else equal, achieving a 7% rate of return will be more difficult. Just since the asset allocation was approved in October, the 10 year and 30 year Treasury rates have declined by 73 and 179 bps respectively.

Ms. Pogue presented projections and the financial impact of reducing the interest rate from 7.0% to 6.75% and 6.5% for PERF, TRF "1996 Account", TRF "Pre-96 Account", and HB 1376. Ms. Pogue highlighted key consideration points for the interest rate / investment return discussion. The overall investment policy and strategy should determine how funds are invested. She recommended that the investment return from INPRS asset allocation match the interest rate / investment return actuarial assumption. INPRS Management, in conjunction with INPRS' consultants, estimate the current asset allocation targets generate an overall return of 6.75%.

Ms. Pogue reviewed a summary chart of major actuarial valuation assumptions and methods. Board member asked about the impact on the 1977 Fund. Ms. Pogue provided the information.

Ms. Pogue presented the staff recommendations for adoption of assumptions. A motion and second for adoption were made by the Board. Chairman Cochran opened the floor for questions and discussion.

A discussion was had among Board and staff regarding the process of developing the staff recommended changes. Board member asked about past anticipation for change in employer contribution rates and how the rate change would affect those expectations. Ms. Pogue said that the rates were expected to increase and verified the anticipated changes.

INPRS Staff recommended adopting Resolution No. 2012-06-03: Adoption of Actuarial Assumptions per the following:

- *Interest Rate / Investment Return: All DB Plans*
    - *6.75%*
- *Future Salary Increases Assumption: TRF only*
    - *Weighted average increase of 4.79%*
    - *Recommendation for approval in Experience Study review*
- *Mortality Assumption: All DB Plans*
    - *2013 IRS Static Table Projected Forward Five (5) Years to 2018*

MOTION duly made and carried to adopt the staff recommended Resolution No. 2012-06-03: Adoption of Actuarial Assumptions as summarized above.

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

- Actuarial Factors for Calculating Member Benefit Payments

Ms. Pogue reviewed the responsibilities of the INPRS Board with regard to actuarial factors as defined by the Indiana Code. In providing background of the actuarial factors, Ms. Pogue stated that the factors had not changed since 2001.

INPRS staff recommended continuing the study of changing factors by reviewing: 1) actuarial factors for calculating members' benefit payments and 2) interest rate used to convert a member's ASA and/or RSA to a monthly annuity payment. Staff also recommended that if the Board were to approve changes to factors, approval would be required in the September 2012 Board Meeting. Approval would be required for implementation in conjunction with the "go live" of INPAS (scheduled for April 2013).

H. FY13 Internal Audit Plan

Teresa Snedigar introduced the INPRS Internal Audit team: Keith Hall, Beth Meyer, and Katrina Farley. Ms. Snedigar provided an overview of the Fiscal Year 2012 audit process and high level findings from the 16 audits that were completed. Internal Audit participated in Project Implementation teams for ERM and INPAS consulting on control design and system access roles. This involvement will allow for effective audit of the controls. Ms. Snedigar touched on some of the high level findings from the audit: the need to enhance vendor management process and the need to enhance controls over manual calculations in retirement processing and segregation of duties in smaller funds. Ernst & Young was invited to review the newly implemented Oracle EBS system; they specifically looked at logical access and maintenance of that system by the INPRS IT area. Audit worked with Investments to develop controls for monitoring FX transactions. The need to enhance controls over the policy and procedure manual process was also identified in the audit. Ms. Snedigar informed the Board that all action plans are current and appear to fit the guidelines specified by the audit team.

Board members discussed the involvement of the Audit Committee and suggested meeting in July 2012.

Ms. Snedigar explained the Fiscal Year 2013 Audit Plan. Process documents, risk rankings, and heat map and proposed audit were given to the Board for their review. She summarized the audit process and the development of an audit universe: interviews and surveys of management were used along with risk rankings based upon several factors (including financial impact, reputation, and fraud risk of processes). The audit plan focuses on improving and monitoring controls. Eighteen projects have been scheduled for the next year, including review of all IT functions. Audit team will continue to participate in new system implementation projects and to enhance the Fraud quarterly analytics for new systems as they go live. For continuous improvement of the audit process and to align with the standards of the Institute of Internal Audit, the team will implement a quality assurance program over the Internal Audit function. Ms. Snedigar discussed additional plans for external review of the Internal Audit department.

Mr. Russo commended Ms. Snedigar and her staff on the development of the Internal Audit department and processes.

IV. Unfinished Business

A. Guaranteed Fund Study

Mr. Russo updated the Board on the status of the Guaranteed Fund ("GF") evaluation project: the Statement of Work with Capital Cities has been finalized and some work has begun. Mr. Russo introduced Joe Bill Wiley and Amanda Black from CapCities to present an update to the Board on their evaluation of the Guaranteed Fund. Mr. Wiley gave an overview of the project to the Board. CapCities will assist INPRS in conducting a study that serves to describe the Fund within the historical context of the offering, in light of the current market environment and in comparison to peers and industry best practices. Ms. Black expressed that the focus of their work so far has been to study the GF in light of the current investing environment and assessing the pros and cons of offering a guaranteed rate. Mr. Wiley explained that the report will allow the Board to uphold their fiduciary duty by understanding the industry standards and comparing the GF to other options. CapCities will also provide possible alternatives to the GF for the Board to consider.

A discussion was initiated by Board members regarding the evaluation of the GF as a short-term investment compared with the general view of GF members that it is a long-term investment.

Mr. Russo reminded the Board of the language in the Indiana Code regarding the Guaranteed Fund and its requirements. A discussion was had among the Board and staff about the history of the GF rate and the effect of having the GF as the default investment option for so many years. Mr. Russo gave a brief history of the GF program.

Board member expressed support of CapCities' project plan and asked for information about the format of proposed alternatives to the GF. Ms. Black responded that they plan to offer legislative impact, fiduciary considerations, and potential participant impact for each of the alternatives.

Mr. Russo referred to a conversation at the April Board Meeting about member enrollment in investment options and stated that, based on Indiana Code, the Board cannot "reset" or otherwise change a member's option after it has been selected.

CapCities will meet with INPRS staff early in their study to capture all information surrounding current Indiana and Administrative Code and procedures regarding the GF.

V. <u>New Business</u>

A. <u>Financial Update</u>

Ms. Pogue reviewed the financial highlights as of May 2012. Losses in May resulted in a net loss of almost $500m for the fiscal year. Ms. Pogue summarized the factors that contributed to the change in net position for the year: a loss in investments, as well as benefit payouts and expenses being greater than contributions received. Ms. Pogue also summarized the INPRS Actual and Forecasted Expenses as compared to the Budget for FY2012. Overall, INPRS would be favorable to budget. She highlighted points from the Annual Variance Analysis. Administration had a favorable variance that was driven primarily by lower personnel and related costs. Projects was favorably affected by moving expenses thought to have occurred in FY12 to the Budget for FY13 that was just approved. The favorable variance in Investments was primarily due to management fees. Two factors causing Capital to be below budget were the savings resulting from vendor selection and the retiming of INPAS development costs.

B. <u>Investments Update</u>

Mr. Cooper began the investment update with a review of the INPRS asset allocation using new graphs comparing the target range and current actual allocation and showing progress of each asset class. Risk on/risk off environment, global growth concerns, and overall volatility were key factors affecting the economic environment. Mr. Cooper discussed the effect of the economic environment on the different asset classes and noted the importance of diversification. In reviewing peak to trough performance, he noted that the INPRS DB market value has continued to perform well and is nearing the peak market value last reached in 2007. Mr. Cooper presented a performance update on Risk Parity: based on a very short time frame (March 14, 2012 to June 13, 2012) it had performed very well with a cumulative return of 0.3%. He then reviewed the DB performance, noting that fixed income underperformance is due to INPRS having more corporate bonds than Treasury bonds. In comparing private investment performance and public equity, Mr. Cooper discussed the positive performance of private equity and explained that the measurement for private real estate may not be fair due to lower risk debt investments in the portfolio. Mr. Cooper reviewed charts showing return attribution by economic environment that compared actual allocation and target allocation. He briefly reviewed the charts showing historical asset class returns, noting that there was little change from April 2012 and there is no pattern.

Mr. Cooper pointed out several new investments that had been previously discussed by the Investment Committee and noted that about $200 million remain to be invested this year to stay on track with goals for the private equity portfolio. Recent terminations were a byproduct of consolidation, focusing on streamlining private equity and fixed income; the number of public equity managers was reduced from 34 to 18. The Watch List and other factors were used to reduce the overall number of managers.

Mr. Cooper explained the purpose of the Watch List as a tool and the benchmark criteria used to add and remove investment managers from the list.

C. <u>Executive Director Report</u>

Steve Russo presented the Executive Director's report. He updated the Board on the ongoing modernization efforts. The Employer Reporting & Maintenance (ERM) project is on track to go-live October 2012. All "agency code" development was completed. Employer "soft-open" will be offered from July 2 to September 23, 2012. ERM system and user testing will continue through September. The Defined Benefit system (INPAS) project remains on track.

Mr. Russo presented metrics highlights for the Governor's Dashboard: the 10 year actual return compared to the actuarial target is 199 bps below the 7% target and the percentage of on-time retirements and customer satisfaction remain in the green. Highlights of Board Dashboard Metrics were: overall strong performance and upward trends, 1-year investment return is trailing the benchmark by 60 bps, the percentage of Recent Retiree Satisfaction is showing a downward trend (being investigated by staff), and the Call Satisfaction has dampened and is trending upward.

D. Other business as requested by the Board

No other business was brought forth.

VI. Preliminary Agenda for September Board Meeting

Mr. Russo proposed a draft agenda for the September 14, 2012 Board Retreat. Board members suggested adding a discussion of the Audit Plan to the agenda.

VII. Adjournment

MOTION duly made and carried to adjourn the June 29, 2012 Board meeting at 12:55 p.m.

Proposed by: ***Bret Swanson***
Seconded by: ***Tim Berry***
Votes: ***6 in favor, 0 opposed, 0 abstentions***