South Carolina Public Employee Benefit Authority

Retirement Policy Committee Meeting
Meeting Minutes as adopted April 15, 2013

Wednesday, January 16, 2013

2nd Floor Conference Room
202 Arbor Lake Drive
Columbia, South Carolina 29223

Board Members Present:

Mr. John Sowards, Chairman (in person)
Mr. Frank Fusco (in person)
Mr. David Tigges (in person)
Mr. Art Bjontegard (in person)

Others present for all or a portion of the meeting:

David Avant, Lil Hayes, Robbie Bell, Stephen Van Camp, Justin Werner, Tammy Nichols from the South Carolina Public Employee Benefit Authority (PEBA); Daniel Brannon from the State Treasurer's Office; Jennifer Hyler from Senate Finance; Ed Poliakoff for TIAA-Cref; Sarah Corbett from the SC Retirement System Investment Commission; Donald Tudor from the South Carolina State Retirees Association.

I. CALL TO ORDER

Chairman Sowards called the meeting to order at 9:04 a.m.

A. Compliance with SC FOIA Requirements

Ms. Hayes confirmed meeting notice compliance with the Freedom of Information Act.

B. Adoption of Proposed Agenda

No objection from the committee to adopting the proposed agenda.

II. REVIEW GROUP TRUST DOCUMENT FOR SC RETIREMENT SYSTEMS (SCRS)

Mr. Avant introduced the Group Trust Document. He explained that in 2008, the Group Trust was codified to explain who the trustees are and the purpose of the trust. This is in compliance with IRS regulations. He also explained that there are "private letter rulings" which address specific situations which are scrutinized by the IRS for compliance. He explained that PEBA legal counsel has created a discrete Group Trust Document which does no more or no less than what the IRS codes require. He explained that the discrete trust document will also aid in maintaining compliance with regard to potential foreign investments by the SCRSIC. Chairman Sowards asked for any questions from the committee. Mr. Tigges asked whether this is an annual requirement. Mr. Avant stated that it is a one-time or “as-needed” basis. Chairman Sowards asked for a motion to recommend the Group Trust Document to the PEBA Board. Mr. Fusco moved to recommend the Group Trust Document to the Board. Mr. Tigges seconded. Unanimously approved.

III. REVIEW OF 2012 VALUATIONS (SCRS, PORS, GARS, JSRS, NATIONAL GUARD)

Chairman Sowards introduced the 2012 valuations of each retirement system. He explained that these are valuations based upon the FY12 ending June 30, 2012. Mr. Avant introduced Tammy Nichols to explain the valuations. Ms. Nichols explained that the draft valuations are generally distributed around the end of December or early January. She explained that these valuations are projected to the second fiscal year from when the valuations are published. This means that the second fiscal year is the year in which the contribution changes are adjusted based on the current valuation. She explained that the valuations are executive summaries. She began with SCRS. She noted that there was a significant decrease in active members at the same time that there was a significant increase in retirees. Mr. Avant explained that the distinction between active and inactive members concerns the fact that active members are the basis for the increasing liability whereas the liability for current retirees is set. She explained that because of the change to no longer pay interest on inactive accounts many non-retirees opted to remove their contributions. She explained that the projected payroll totals $9 billion, of which $7 billion is active payroll. She explained that the assumption for valuations is based upon a 3% payroll increase annually. Mr. Avant explained that these assumptions are within the discretion of the PEBA Board to determine. Chairman Sowards asked what would happen if the Board adjusted the 3% payroll increase assumption. Ms. Nichols explained that the actuaries discourage reactionary adjustments to the assumptions because their projections are long-term. She also explained that changes to one assumption will impact all the other assumptions. Chairman Sowards clarified that a change to the assumption now would have an ever-increasing impact on the future liabilities and the plan’s ability to meet these liabilities. Mr. Bjontegard asked where a shortfall in contributions would be seen. Ms. Nichols explained that there will likely be a decrease in the number of working retirees in the coming years. Mr. Avant explained that employers are less likely to bring back seasoned employees at higher salaries because of the poor economy. Mr. Tigges interjected that because the assumption is a 3% increase—but the last two years it has decreased by over 3%—it is actually a 6% swing in the opposite direction which will later need to be compensated for with increasing contribution rates. Mr. Avant explained that at the January 31, 2013 meeting in Wampee, the actuaries will provide clarifying information on these issues. Mr. Fusco asked for an explanation for the decrease in active members, since historically local governments have been growing. Ms. Nichols directed the committee members to a table on page 30 in the SCRS valuation publication which separates participating employers into various types. Mr. Avant explained that the increase in local government employees is offset by significant decreases in state and school district employees, making the total numbers relatively stable. Chairman Sowards asked whether these shortfalls will affect the amortization periods. Mr. Avant responded yes, and that this will ultimately result in upward pressure on the contribution rates. Ms. Nichols explained that because increases for SCRS contribution rates are statutorily mandated, these do not require action on the part of the committee or PEBA Board. Mr. Fusco expressed his agreement that the Board does not need to perform any action. Chairman Sowards explained to need to maintain openness to considering whether an action may need to be performed in the future if it appears to be necessary. Mr. Avant added that the Board's required action is to accept the actuarial values (to accept the math). By doing this, the Board is then driving the contribution rates since the statute requires that the accepted valuations determine a requisite increase in the contribution rates. Mr. Bjontegard expressed his concern that because the PEBA Board controls the liability of the plan but the SCRSIC controls the assets, he doesn't see that there is a need for the Board to do anything regarding the investment assumptions. Ms. Nichols responded that there is an asset/liability study in progress which will help determine the need for changes to assumptions. Ms. Corbett added that the report will not be finalized prior to the Wampee meeting, though there will be preliminary information presented there. Mr. Bjontegard further stated his belief that the Board cannot do anything about what it views as faulty assumptions for the investment returns. Mr. Avant responded that the Board's responsibility is to remain informed as trustees and make recommendations to the legislature as to the need for changes. Mr. Fusco added that he is concerned that choosing a fixed point in time upon which the Board will make decisions may be misguided because of market volatility. Mr. Avant added that actuarial smoothing and long-term forecasts are better bases for decision-making. Chairman Sowards reminded the committee of the GRS actuaries' comments in the September 2012 PEBA Board meeting that time periods of 5 or 10 years are short-sighted and that their assumptions are based more upon horizons 30, 40, or 50 years in the future. Mr. Avant added that the actuaries consider multiple factors in deciding appropriate assumptions. Chairman Sowards asserted that the actuaries are the experts and that unless the Board members have more information than the actuaries or are better informed/educated that the actuaries, there is not really any room to question the assumptions the actuaries make. Mr. Tigges agreed. Mr. Fusco asked about the assumed rate-of-return percentages for other plans. Ms. Nichols responded that other plans range from 3% to 10%, with 5% being the most common assumed rate-of-return for other public plans. Mr. Tigges asked how the General Assembly agreed on a 7.5% assumed rate-of-return. Ms. Nichols explained that an experience study conducted by GRS confirmed this as an appropriate assumption. Mr. Fusco added that skepticism over the 7.5% could be taken in light of the fact that the plan attained an 18% rate-of-return last year—which would not have been predicted. Mr. Bjontegard stated that different investment experts will disagree on what rates-of-return are attainable, but that the Board needs to continue discussions, since it appears the Board has advisory responsibility with regard to the GA's assumed rate-of-return. Mr. Tigges reiterated that factors cannot be taken individually but as a whole. Mr. Avant agreed, adding that erroneous adjustments to a certain factor or factors without regard to the other factors can result in unforeseen negative consequences. Chairman Sowards asked Ms. Nichols to continue with her presentation of the valuations. She explained that the "cost of service" for FY12 increased slightly. She also noted that the unfunded liability increased. She added that the number of retirees spiked in 2012 and will increase again in 2013 because of the changes in the law. Mr. Fusco asked how these anomalies will affect projections. Ms. Nichols and Mr. Avant responded that the actuaries were aware of potential anomalies based upon the changes in the law. Mr. Avant added that the actuaries commented that the effects of these spikes will be negligible in the long-term. Mr. Fusco responded that long-term effects may be negligible by themselves, but when taken collectively they could have a greater affect. Chairman Sowards moved the agenda, noting that Mr. Tigges will need to leave by 10:30 a.m. Ms. Nichols noted that the only aspect of her report that requires action by the Board is to approve the increase to the PORS contribution rate increase, because it exceeds what is permitted by statute. Ms. Nichols added that a key takeaway from these reports is that contribution rate increases will be inevitable to compensate for the $6 billion investment losses experienced by the plan in 2008 and further losses in 2009 and 2010. Chairman Sowards stated that the valuations need to be on the next PEBA Board agenda for its approval. He requested a motion to recommend the valuations to the Board for its approval. Mr. Tigges moved to recommend the valuations to the Board for approval. Mr. Fusco seconded. Mr. Tigges added that the committee/Board has no choice but to rely on the information provided to it. Mr. Fusco agreed and requested a report of the fiscal impact on the different types of employers by funding source, including local governments, resulting from the required contribution changes arising from the valuations. The pending motion was unanimously approved.

IV. SC INVESTMENT COMMISSION (SCRSIC): RISK ANALYSIS UPDATE

Chairman Sowards formally introduced Ms. Corbett to present information on the relationship between the SCRSIC and the PEBA Board. He added that the PEBA Board and the SCRSIC should consider meeting together regularly to improve communication. Ms. Corbett echoed Chairman Sowards' assertion that the SCRSIC and PEBA should be collaborative in their functions. She began by stating that the value of the retirement fund has decreased because the benefits being paid out exceed the income of the plan (contributions).

(*Mr. Tigges excused himself at 10:18 am*).

Ms. Corbett gave an overview of the SCRSIC. She distributed a binder with information, including the Commission's website and history. She explained the governing laws for the SCRSIC and how it relates to PEBA. She added that there are statutes which establish codes of conduct for SCRSIC officers and staff. She mentioned the SCRSIC's governance documents. The next item in Ms. Corbett's presentation was the SCRSIC's *Annual Investment Plan*. Mr. Avant asked what is annually required of the SCRSIC. Ms. Corbett responded that the *AIP* and the *Statement of Investment Objectives and Policies* are required to be provided to the SCRSIC regularly. Mr. Fusco asked whether the Budget and Control Board has any approval authority over the actions of the SCRSIC. Ms. Corbett responded that the governing statute assigns exclusive authority to the SCRSIC. She added that all members of the Commission have voting rights except the PEBA Executive Director. Chairman Sowards noted that having the ED of PEBA as a non-voting member offers a measure of protection for the PEBA Board against any liability resulting from the actions of the SCRSIC. Mr. Avant added that the Chief Information Officer of the SCRSIC, Mr. Herschel Harper, will present to the PEBA Board at the March 20, 2013 meeting. Ms. Corbett continued by explaining the SCRSIC's due diligence guidelines, which govern how the Commission chooses, oversees, and discharges its asset managers. She also explained that the SCRSIC has employed Deloitte and Touche LLP to conduct internal audits of the SCRSIC and its operations. She explained that the results of the first audit include adopting the Due Diligence Guidelines as policy, establishing a dashboard of measures to assess the performance of the SCRSIC, and adding an internal audit department. She added that the Commission has also added staff to improve operations and administration of the SCRSIC agency. She explained that a performance investment commission plan has been implemented to aid in recruiting and retaining competent staff at SCRSIC. Ms. Corbett also added that the SCRSIC and PEBA will continue working together to identify opportunities to improve, such as enhancing software for accounting and portfolio management. Among measures that still require action by the SCRSIC are enhancements to infrastructure and increasing staff size. Mr. Bjontegard asked whether the SCRSIC's technological resources are more vulnerable than PEBA's. Mr. Avant responded that they are monitored by the same resources and in the same way as PEBA's systems. Ms. Corbett added that the SCRSIC's IT Director could come to speak with the PEBA Board. Ms. Hayes suggested that he be included on the agenda for the March 20, 2013 Board meeting. Mr. Fusco added that PEBA and the SCRSIC should work together to pool resources and link systems to reduce costs and enhance security. Mr. Fusco asked whether PEBA has an IT plan. Mr. Avant responded that there is an IT plan included with the overall PEBA strategic plan. Mr. Bjontegard requested a strategic planning document from the SCRSIC. Ms. Corbett agreed to provide a copy of the expired strategic plan. Mr. Fusco requested a copy of strategic planning for PEBA IT, to assess opportunities for cooperation between SCRSIC and PEBA. Mr. Avant responded that staff can provide that to the Board.

V. DISCUSSION OF PORS DISABILITY RETIREMENT ISSUES

Chairman Sowards reintroduced the Disability Study distributed to the PEBA Board at the December 12, 2012 meeting. He explained that there are some contentious aspects to the changes in approval criteria for disability retirement under the PORS system. Mr. Avant explained that the changes mean that a PORS disability retiree will be subject to review of eligibility after three years, based upon the criteria maintained by Social Security regarding inability to obtain gainful employment. Chairman Sowards commented that this is a significantly more stringent standard. He added that another change revises the projection target for calculating the disability retirement benefit for PORS members from age 55 to what would have been the member's 25th year of service. Mr. Bjontegard asked who the legislative sponsor of the provision that included changes in these criteria. Mr. Avant responded that it is not clear who sponsored the provision, as it was a part of the PEBA enabling legislation. Chairman Sowards asked who is affected by these changes. Mr. Werner responded that no one who is already retired will be affected and that anyone who submits their complete application before January 1, 2014 would be affected. Chairman Sowards asked how these changes affect the other systems. Mr. Werner responded that the effect on SCRS members is more drastic. He elaborated that the SSA standard of any gainful employment disability is the standard of initial eligibility for disability retirees from SCRS. Mr. Avant added that these disability retirees not only have to meet the SSA standards, but must actually provide proof of their approval for Social Security disability benefits. Mr. Fusco expressed his desire to have the study include an examination of the process of approval to identify ways to decrease the time for approval while also legitimizing those situations which are approved. He asked PEBA staff to confirm that, in the past, a board of medical staff employed with retirement was responsible to review the disability claims and that this board was eliminated. Mr. Van Camp confirmed that this board existed but was eliminated in or around 2005 because it was viewed by some that the medical board did not add value to the process. He also noted that—while it may not be the only or most important factor—shortly after the medical board was eliminated, the approval rate for disability retirement applications increased. Mr. Fusco asked for information identifying the cause of such anomalies as the fact that the number of approvals in South Carolina exceeds the norm. He also expressed his concern that a legitimately disabled employee is not denied his rightful benefit because of the delays required by these changes. He noted that the average approval window would change under these revisions from 85 days to 252 days. Chairman Sowards clarified Mr. Fusco's point that an assessment should be made as to whether the changes made to the criteria are the best and/or most effective options to improve the condition of the plan. Mr. Bjontegard suggested that the committee request PEBA staff to review the data and possibly conduct a second study to gain further information on the benefits achieved by these changes and what the Board's future considerations should be. Chairman Sowards asked who the principle authors of the study are. Mr. Van Camp responded that he and Mr. Werner drafted the report with the design to answer the question being asked in the legislation. Chairman Sowards suggested tabling the discussion regarding the disability study and coming back to it once PEBA staff has had the opportunity to assess what data they produced in the course of researching in preparation of the report. He suggested scheduling a March meeting of the committee to review staff's findings from further investigation of the disability data. Mr. Bjontegard suggested having the committee create an explanation of its responsibilities and duties to include in the "trustees handbook." He also suggested reviewing the SCRSIC long-range plan to identify how it can be used in conjunction with PEBA's long-range plans.

VI. ADJOURNMENT

Chairman Sowards reminded committee members that they are required to file a new Statement of Economic Interest with the State Ethics Commission for 2012 before April 15, 2013 or incur a $100 fine per day after that deadline. He also suggested that future meetings should be limited in time to about an hour and a half—even if this means limiting the agenda.

There being no further business, Chairman Sowards adjourned the meeting at 11:34 a.m.