Employees' Retirement Board of Rhode Island
Monthly Meeting Minutes
Wednesday, April 13, 2011
9:00 a.m.
8th Floor Conference Room, 40 Fountain Street

The Monthly Meeting of the Retirement Board was called to order at 9:00 a.m. Wednesday, April 13, 2011, on the 8th Floor Conference Room, 40 Fountain Street, Providence, RI.

I. Roll Call of Members

The following members were present at roll call: General Treasurer Gina M. Raimondo; Vice Chair William B. Finelli; Daniel L. Beardsley; Frank R. Benell, Jr.; Michael R. Boyce; M. Carl Heintzelman; Richard A. Licht; John P. Maguire; John J. Meehan; Thomas A. Mullaney; Louis M. Prata, and Jean Rondeau.

Also in attendance: Frank J. Karpinski, ERSRI Executive Director; Attorney Michael P. Robinson, Board Counsel.

Recognizing a quorum, Treasurer Raimondo called the meeting to order.

The following board members arrived after the roll call: Gary R. Alger and Roger P. Boudreau arrived at 9:05.Linda C. Riendeau arrived at 9:10.

II. Approval of Minutes

On a motion by Frank R. Benell, Jr., and seconded by Thomas A. Mullaney, it was unanimously

VOTED: To approve the draft minutes of the March 9, 2011 meeting of the Employees' Retirement System of Rhode Island Board.

III. Chairperson's Report

Treasurer Raimondo provided an investment update to the Board. She said the February return was 1.98%, the year-to-date return was 3.1% and the 10-year return was 5.16%. The Treasurer said the assets under management as of today are $7.4 billion which is $1 billion off when the market crashed when assets were at $8.4 billion.

Treasurer Raimondo apprised the Board of the valuation time line and stressed importance of making a decision today on the actuarial experience study which is required to complete the annual valuation for the May Board meeting. She said the updated information will be critical for the States next bond offering which is likely to be in May or June. The Treasurer reminded the Board that the State is currently involved in an ongoing investigation with the SEC and one item of importance is to provide the most updated information in the next bond offering. Treasurer Raimondo advised the Board that if the recommendations of the system actuaries and financial advisors are not adopted, the State would to be compelled to disclose such information in the next bond offering and it could negatively impact the States experience in the bond market.

IV. Executive Director's Report

Director Karpinski updated the Board on the status of the paperless direct deposit stubs. Currently there are 24,837 members who receive direct deposit pension payments, of that group, 4,944 created new accounts online, 6,724 requested hard copies and the remaining 13,169 members have neither called ERSRI for a hard copy nor set up an online account.

Treasurer Raimondo thanked Director Karpinski and the ERSRI staff for their due diligence in the transition from paper to online direct deposit stubs. Director Karpinski thanked the Treasurer for her kind words and praised the efforts of a great staff.

V. Presentation and Potential Approval of the Experience Study for the period ending June 30, 2010

- *Financial Market Analysis and Review by Pension Consulting Alliance, Inc.*

The Treasurer invited Mr. Allan Emkin of Pension Consulting Alliance, Inc. (PCA) to begin his presentation. He began by stating the equation of Investment Earnings + Contributions = Benefit Payments + Expenses. He said his presentation will focus on investment earnings. Mr. Emkin said that long-term investors should expect lower capital market returns over the next decade than historical averages.

Mr. Emkin said that the world has changed for long-term investors. He said factors that provided a tailwind in the past are expected to present a headwind such as lower interest rate environments and higher debt levels. He said growing capital flows increase the potential for global capital market volatility. The take-away is that powerful secular trends have the potential to influence the investment landscape in a negative way for the next decade and possibly beyond.

Mr. Emkin then discussed the lower interest rate environment. He said that future expected returns from fixed income will be lower than in the past and said the take-away is that Rhode Island can expect a 3.3% to 3.5% return on 20% plus of the investment portfolio over the next decade.

Mr. Emkin told the Board that debt levels are higher. He said the U.S. Government and the citizenry have over-extended their debt burdens. Western Europe and Japan also have heavy debt loads. He told the Board that interest payments and debt repayment can crowd out future purchases and economic projects pointing to lower economic growth prospects and potentially lower equity market returns.

Mr. Emkin then discussed federal debt as a percentage of GDP and said debt can have the effect of pushing forward purchases at the expense of purchases in current years which can lead to slower economic growth.

Mr. Emkin discussed additional factors contributing to lower economic growth prospects in the developed economies such as aging populations, slowing population growth and as a result, economic growth is expected to be lower in the developed market economies. He said the take away is that lower economic growth prospects in the developed markets point to lower equity market returns. Also, as financial wealth becomes more equally distributed globally, the potential for market volatility increases as various economic interests compete in the marketplace.

Mr. Emkin discussed equity market expectations and told the Board that equity markets are not priced cheaply. He said it is unlikely that a sustainable long-term bull market for equities would start from current market valuation levels. Historically low dividend yield, lower economic growth expectations and a fairly priced equity market are not predictive of strong equity market returns.

Mr. Emkin then discussed ten-year capital market expectations using both arithmetic and geometric returns in which he said you may only spend the geometric dollars—not the arithmetic dollars and concluded with a discussion of projected public fund 10 year returns.

Mr. Emkin then discussed the ERSRI portfolio. A mature plan does not have the luxury of waiting for growth to materialize. Benefits have to be paid today and a low interest rate environment makes meeting benefit payments more difficult. Mr. Emkin said based on the portfolio policy asset mix and the PCA 2011 ten-year capital market assumptions, the expected compound return is 6.7%. He told the Board that given the PCA capital market return assumptions and the current portfolio policy asset mix, the probability of achieving at least a 7.5% compounded return is 42.5%.

Mr. Emkin discussed his conclusions and said powerful secular trends are likely to restrain capital market rates of return for the next decade and possibly beyond. He said moderate economic growth prospects in the developed markets point to lower equity market returns and as financial assets become more equally distributed globally (Sovereign Wealth Funds and growing middle classes in the developing counties) the likelihood of increased market volatility increases as various economic interests compete in the marketplace. Over the next decade long-term investors should expect lower capital market returns than historical averages.

Mr. Emkin concluded his presentation with a discussion of ERSRI's 9.21% return since 1984. He said past investment returns are explained better by their starting point than their ending point. He told the Board that conditions in the financial markets today are much more similar to the conditions that existed in 1998 than in 1984 and future investment returns are more likely to reflect returns since 1998 (5.4% return) than returns since 1984 (9.2% return).

Treasurer Raimondo thanked Mr. Emkin for his presentation.

- *Actuarial Experience Study by Gabriel, Roeder, Smith and Company*

Treasurer Raimondo then introduced Messer's J. Christian Conradi and Joseph Newton of Gabriel, Roeder, Smith and Company (GRS) to present the actuarial experience study as of June 30, 2010.

Mr. Newton began the presentation with an explanation of the purpose of an experience study. He said assumptions are not static; they should occasionally change to reflect new information, mortality improvement, changing patterns of retirements, terminations, etc. and changing knowledge. He said recent experience provides strong guidance for some assumptions and weak guidance for others.

The guidelines for the assumption setting process are set by the *Actuarial Standards of Practice:*

- ASOP #4 Measuring Pension Obligations
- ASOP #27 Selection of Economic Assumptions (There is a new proposed standard that is expected to become effective later in 2011)
- ASOP #35 Selection of Demographic and Other -Noneconomic Assumptions
- ASOP #44 Selection and Use of Asset Valuation Methods

Mr. Newton then apprised the Board of the procedures used in the experience study. He said they compare economic assumptions to general US price inflation and wage inflation statistics, ERSRI specific salary increases. Expected returns using capital market assumptions and economic assumptions should be consistent. They then analyze demographic assumptions of retirement, mortality, disability, other terminations, compare to ERSRI's actual experience, use Actual-to-Expected (A/E) ratios as an analysis tool and look at patterns by age and service.

Mr. Newton said that if A/E = 100% at all ages, the assumption is "perfect", although GRS may want to build in some margin for conservatism. Mr. Newton told the Board that GRS generally uses data from the last six years, i.e. FY 2005 – FY 2010 but used last ten years for salaries and terminations due to variability.

Mr. Newton provided the Board with some general findings. He said the funded ratio has trended down over the last decade mostly due to investment performance, but also liability experience. Contribution rates have correspondingly trended up sharply, and are expected to continue to do so. He said the assumptions have already been strengthened in 2003 and 2006. Mr. Newton told the Board that future economic growth is likely to be suppressed compared to historical levels and thus current inflation, wage inflation, payroll growth, and investment return rate need to be lowered. He also said that retirees are living longer based on national trends; the Rhode Island experience confirms this trend and increases in life expectancy are likely to continue. Mr. Newton told the Board that most of the other assumptions continue to be appropriate.

Mr. Newton said that the assumed inflation rate (currently 3.00% per year) is not used directly in the actuarial valuation, but it impacts the development of the investment return assumption, the salary increase assumptions and the payroll growth rate. He apprised the Board that GRS recommends lowering this assumption to 2.75% which is closer to recent levels (2.82% over last 25 years), closer to levels expected in the bond market and closer to investment consultants and professional forecaster estimates.

Mr. Maguire asked about the survey of 125 public pension plans that shows the mean assumed inflation rate for large public retirement systems is 3.5%. GRS said the current 3% assumption is used by 30% of the survey of the systems with all the rest using higher assumptions. Mr. Maguire asked if ERSRI moves the assumptions to 2.75% will it be an outlier with the inflation assumption. Mr. Newton said yes. However, he said the survey is a bit dated and can be up to 2 years behind. He said trends are clearly down.

Mr. Newton then discussed the investment return assumption. He said the current assumption is 8.25% which represents the return, net of all administrative and investment expenses. He said the current assumption equals 3.00% inflation plus 5.70% real return (8.70% gross), less 0.45% for investment and administrative expenses. Mr. Newton's recommended change in inflation lowers nominal assumption to 8.00% before any adjustments to the real return assumption 2.75% + 5.25% (net of expenses). He apprised the Board that GRS recommends a change in the real return to reduce the nominal assumption to 7.50%; 2.75% + 4.75% (net of expenses).

Mr. Beardsley questioned the history of market net returns starting in 1996 when the Board adopted an 8.25% return assumption. He said the subsequent year returns, displayed by GRS, appeared to average over 8.25% and suggested that the actions taken by the Board in 1996, relating to the increase to 8.25%, was not outside the norm. Additionally, he said he did not recall GRS having major concerns regarding the increase. Mr. Conradi said GRS recommended an 8% return assumption in 1996 and while a subsequent period of years returned at least 8.25%, he said no expert is capable of predicting returns within 1/4%. Mr. Conradi reminded the Board that GRS recommended 8% in the 6/30/2006 experience study but the Board voted to maintain the 8.25% assumption.

Mr. Boyce asked GRS about the *ASOP #27 Selection of Economic Assumptions* discussed earlier and its implication. Mr. Conradi said that this is a new proposed standard that is expected to become effective later in 2011. He said the old standard prescribes that if assumptions are between the 25th and 75th percentiles, they are considered in the range of reasonableness. Mr. Newton said the new standard appears to be more specific and will require the actuary pick a particular point. He cited the *real return above inflation* analysis and said applying ASOP#27, the investment rate of return would need to be between 6.89% and 7.59%.

Interpreting ASOP #27, Mr. Boudreau asked if a 0.25% change to the recommended investment rate of return assumption would be deemed unreasonable even though it is not consistent with the recommendation of GRS. He also asked the Treasurer how such a suggested change would/could impact the SEC disclosure. Treasurer Raimondo reiterated her earlier comments and felt such a deviation from the actuary's recommendation would need to be disclosed. Mr. Conradi said while he could not speak for the SEC and bond disclosure, he said if the Board adopted a 7.75% rate of return, it would still be in GRS's range of reasonableness and GRS would not flag such a change in their reports. However, he said anything beyond 7.75% would require disclosure in the valuations.

Mr. Newton then continued and said the investment return assumption should be reduced for investment and administrative expenses that are expected to be paid from the plan. He recommended decreasing the adjustment for expenses from 0.45% to 0.40% to reflect the plan's increased utilization of a passive investment strategy and to be closer to recent experience (0.37% for FY2009 and 0.35% for FY2010).

Mr. Newton next discussed the real return above inflation. He said investment returns are uncertain and volatile. Therefore, he said it is also important to review the expected distribution of returns based on the capital market assumptions. He provided the Board with a table with the 25th to 75th percentile range of the expected long-term return. He apprised the Board that the probability of exceeding an average return of 8.25% over a 20-year period is only 31%.

Mr. Newton concluded his remarks on the investment rate of return and said that GRS recommends the ERSRI Board decrease the current net investment return assumption to 7.50%. He said GRS no longer believes an investment return assumption of 8.25% is in the range of reasonable assumptions. Mr. Conradi said that decreasing the assumption will both increase the probability that actual returns will exceed the assumption and decrease the amount of the investment losses incurred when the assumption is not met. Mr. Newton provided the following table showing the changes to the investment assumption recommendation.

Change from Inflation	(0.25%)
Change in Asset Allocation	(0.19%)
Change in Expenses	0.05%
Change in Return Expectations	(0.36%)
Total Change	**(0.75%)**

Mr. Newton then began a discussion regarding post-retirement mortality. He told the Board that GRS analyzed non-disabled retirees, comparing actual number of deaths with expected. He said if the A/E ratio is below 100%, retirees will live longer than expected and the current liabilities are understated. Traditionally for this assumption, Mr. Conradi said setting an A/E between 110% and 120% was preferred to allow for future increases in life expectancy. Mr. Newton said life expectancy in Rhode Island is among the longest in the country. He apprised the Board that state employees were combined with MERS for this analysis; there are separate assumptions for teachers.

Mr. Newton told the Board that the current assumption for state employees and MERS is based on 1994 Group Annuity Mortality Table. The male rates were set forward one year and the female rates are unadjusted. The current assumption for teachers based on a GRS developed table specific to teachers, the male rates are unadjusted and female rates are multiplied by 95%. Mr. Newton said the overall experience has overtaken all current margins for future improvement in life expectancy (A/E's below 100%). The assumptions in prior experience study included a 10% margin. He told the Board that this trend has been consistent across most of GRS's clients and in recent national surveys and is becoming more widely accepted that the trend of ever-increasing life expectancies is likely to continue.

Messer's Newton and Conradi then provided the Board with GRS's recommendation for mortality. They said for state employees and MERS, GRS will update to the RP2000 combined mortality table with white collar adjustment; male rates multiplied by 115% and female rates multiplied by 95%. For teachers, they will continue to use GRS's teacher specific table; male rates multiplied by 97% (currently 100%) and female rates multiplied by 92% (currently 95%). For both groups, Mr. Newton said GRS will apply full generational projections using scale AA which is the most common projection table used in the industry. It assumes life expectancy will continue to improve every year going forward which is becoming more of an industry standard.

Mr. Conradi said the changes to the mortality assumptions have a large impact on the liabilities and contribution requirements. However, if the traditional method had been continued and the life expectancy did continue to increase, there would have been a smaller increase now but continued increases in future experience studies.

Mr. Newton then provided the following three tables to the Board displaying the actuarial impact of the changes:

For State Employees:

Draft Valuation Results as of June 30, 2010			
Scenario	**Current**	**Proposed**	**Change**
Normal cost	9.35%	11.39%	2.04%
Unfunded actuarial accrued liability (UAAL)	$2,119	$2,700	$581
Funded ratio	54.4%	48.4%	-6.0%
GASB 25 Annual Required Contribution for FY2013			
Percent of payroll	26.55%	36.34%	9.79%
Dollar amount	$182.5	$246.5	$64.0

For Teachers:

Draft Valuation Results as of June 30, 2010			
Scenario	**Current**	**Proposed**	**Change**
Normal cost	10.00%	11.82%	1.82%
Unfunded actuarial accrued liability (UAAL)	$3,278	$4,133	$855
Funded ratio	54.2%	48.4%	-5.8%
GASB 25 Annual Required Contribution			
Percent of payroll	26.21%	35.25%	9.04%
Dollar amount	$282.8	$375.3	$92.5

For MERS (aggregate):

Draft Valuation Results as of June 30, 2010			
Scenario	**Current**	**Proposed**	**Change**
Normal cost	14.86%	17.70%	2.84%
Unfunded actuarial accrued liability (UAAL)	$237.2	$430.6	$193.4
Funded ratio	83.4%	73.5%	-9.9%
GASB 25 Annual Required Contribution			
Percent of payroll	13.43%	21.76%	8.33%
Dollar amount	$41.1	$66.6	$25.5

Messer's Newton and Conradi thanked the Board for their attention and concluded their presentation. A motion was then made by Gary R. Alger and seconded by Jean Rondeau to accept the recommendations presented by GRS.

Attorney Robinson addressed the Board regarding their roles as fiduciaries.

Mr. Boudreau reiterated his comments regarding the investment rate of return and adopting a 7.75% assumption, since such an amount would still be within a reasonable range considered by GRS. Both Treasurer Raimondo and Mr. Licht addressed the matter and felt strongly that it was more prudent to accept the 7.50% recommendation of GRS.

Treasurer Raimondo then asked Director Karpinski for a roll call vote on the motion made by Mr. Alger and seconded by Mr. Rondeau to accept the recommendations presented by Gabriel, Roeder, Smith and Company for the experience study as of June 30, 2010.

The following members voted Yea: General Treasurer Gina M. Raimondo; William B. Finelli; Gary R. Alger; Daniel L. Beardsley; Frank R. Benell, Jr.; M. Carl Heintzelman; Richard A. Licht; Thomas A. Mullaney and Jean Rondeau. The following members voted nay: Roger P. Boudreau; Michael R. Boyce; John P. Maguire; John J. Meehan; Louis M. Prata and Linda C. Riendeau.

There being 15 votes to cast, 9 voted in the affirmative and 6 nay, consistent with Rhode Island General Laws section 36-8-6, *Votes of the Board–Record of Proceedings*, there being a majority vote of the members present and voting at which a quorum was present, it was

VOTED: To accept the recommendations presented by Gabriel, Roeder, Smith and Company for the experience study as of June 30, 2010.

VI. Administrative Decisions

None this Month

VII. Approval of the March Pensions as Presented by ERSRI

On a motion by Roger P. Boudreau and seconded by Jean Rondeau, it was unanimously.

VOTED: To approve the March pensions as presented.

VIII. Legal Counsel Report

Attorney Michael Robinson updated the Board regarding the *Rivera vs. ERSRI* matter; and made copies available of a favorable decision received from Judge Darigan.

IX. Committee Reports

Disability Subcommittee: The Disability Subcommittee recommended the following actions on disability applications for approval by the full Board as a result of its meeting on April 8, 2011:

	Name	Membership Group	Type	Action
1.	Janice Evans	State	Accidental *(New Law)*	Postpone
2.	Jennifer Csizmesia	Municipal	Accidental	Postpone
3.	Grace Sumney	State	Accidental *(New Law)*	Approve @50%

	Name	Membership Group	Type	Action
4.	Donna-Gayle D’Arezzo	Teacher	Ordinary	Approve
5.	Jennifer Leyden	Teacher	Accidental	Denied

On a motion by William B. Finelli and seconded by Michael R. Boyce, it was unanimously

VOTED: To approve the recommendation of the Disability Subcommittee meeting of Friday, April 8, 2011 on item 5.

John P. Maguire recused himself from the vote on number 5.

On a motion by William B. Finelli and seconded by Michael R. Boyce, it was unanimously

VOTED: To approve the recommendation of the Disability Subcommittee meeting of April 8, 2011 on items 1, 2, 3, and 4.

X. New Business

None this Month

XI. Adjournment

There being no other business to come before the Board, on a motion by Jean Rondeau and seconded by Roger P. Boudreau the meeting adjourned at 11:22 a.m.

Respectfully submitted,

Frank J. Karpinski

Executive Director