



Employees' Retirement Board of Rhode Island
Monthly Meeting Minutes
Thursday, October 13, 2016
9:00 a.m.
2nd Floor Conference Room, 50 Service Avenue

The Monthly Meeting of the Retirement Board was called to order at 9:01 a.m. Thursday, October 13, 2016, in the 2nd Floor Conference Room, 50 Service Avenue, Warwick, RI.

I. Roll Call of Members

The following members were present at roll call: General Treasurer Seth Magaziner; Vice Chair William B. Finelli; Daniel L. Beardsley; Roger P. Boudreau; Mark A. Carruolo; Mark Dingley, designee for Michael DiBiase; Paul L. Dion, PhD.; Thomas M. Lambert; John P. Maguire; Marianne F. Monte; Daniel Orgel, designee for Thomas A. Mullaney; Claire M. Newell and Jean Rondeau.

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

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

Mr. Roger P. Boudreau arrived at 9:03 a.m.

II. Approval of Minutes

On a motion by John P. Maguire and seconded by Marianne F. Monte, it was unanimously

VOTED: To approve the draft regular minutes and the draft executive session minutes of the September 14, 2016 meeting of the Retirement Board of the Employees' Retirement System of Rhode Island.

Mark A. Carruolo abstained from the vote as he was absent.

III. Chairperson's Report

Treasurer Magaziner apprised the Board that the asset and liability study is complete and Mr. Allan Emkin from Pension Consulting Alliance (PCA) will provide the results of the study to the Board. The Treasurer thanked the Board for their feedback from July's joint Board/SIC meeting.

Pension Consulting Alliance (PCA) Asset Liability Study Presentation

Mr. Emkin said the biggest challenge facing the investment portfolio is to recognize the portfolio's main purpose is to maximize the consistency of paying out the benefits to the entitled earners for the next 30-50 years.

Mr. Emkin discussed benefit math of *Contributions + Investment Earnings = Benefit Payments + Expenses*. He said benefit payments are known and relatively easy to forecast, investment earnings are variable and difficult to forecast. Mr. Emkin noted that over the past two decades ERSRI's plan sponsors have always funded the ARC. Mr.

Emkin said the source of benefit payments for the average public pension plan over the past 30 years were:

Investment Return 64%

Employer Contribution 24%

Employee Contribution 12%

Mr. Emkin said there are 2 components to the asset liability analysis where the liability side is driven by the actuary and the asset side is composed of a very complex model and a various amount of assumptions discussed and debated in depth by the SIC. He said the analysis focused on scenario analysis, a range of outcomes with analysis of worst case scenarios i.e. the probability of the funding ratio falling below 50% over the next 30 years and the cost increase to 30% of payroll.

Mr. Dion asked Mr. Emkin with knowing contributions not exceeding more than 30 percent of the pay, was there any constraint on the lower end, for instance, no lower than 25% – 28%; Mr. Emkin said no. Mr. Dion asked if it ever fell below a 25% threshold (in the model). Treasurer Magaziner said yes as in the new portfolio has a lower contribution rate than the current one because it expects the investment returns to be better over time, thus the contribution rate should be lower.

Mr. Emkin said large net negative external cash flow of -5% per year may reduce a mature DB plan's management flexibility. He said large negative market movements (drawdowns) are particularly harmful to plan solvency for mature funds. He noted that under the worst case scenarios, investors are forced to liquidate long-dated assets in down markets or are forced sellers of illiquid assets – at price concessions.

Mr. Maguire asked how compounding is factored in with the assumed rate of return and is there a connection and if so how to make the connection. Mr. Emkin said that compounding the rate of return is arithmetic. Mr. Emkin stressed that benefits are paid with compound returns. However, Mr. Emkin said compounding is great when there is positive growth however compounding is detrimental when negative.

Mr. Emkin apprised the Board of the various components that make up the asset classes. Treasurer Magaziner said when referring to the key risk considerations it is not a prediction of what will happen but what could happen.

Mr. Emkin said each one of the components has an explanation of its characteristics, and each one has gone through the SIC in great detail. The first group is the Growth Class and the US and Non-US Equity; a Private Equity component is owning assets that are not publicly traded in the form of limited partnerships. Next he discussed the Income Class which assists in how to generate significant cash that can be put towards benefit payments. Lastly, Mr. Emkin discussed the Risk Reduction Class, particularly the new *Crisis Risk Offset* strategy. He said the CRO portfolio is expected to produce a meaningful positive return in a protracted financial market crisis where growth risk is suffering. In addition to being negatively correlated with equity (growth) risk, the class must also be volatile enough to produce a meaningful positive (offsetting) return in response to the market drawdown period. Finally, this class should generate a reasonable positive return over a full market cycle, though it will have periods where it is not in favor.

Mr. Emkin then apprised the Board there are other components in the risk reduction class, namely, inflation protection and Investment Grade Fixed Income, giving some level of diversification and current income. Mr. Emkin discussed the asset/liability

model description and noted that GRS is used for the liability model and PCA uses 5,000 potential market scenarios for the asset Model. The long-term goal is to continue progress towards plan full funding (100% in 22 years). He stressed in the modeling optimization that a major factor is minimizing the likelihood the funding level falling below 50% at any point in the next 5 years.

The Treasurer said if there were no constraints, the model would produce a 60% allocation private equity but that it would not be prudent to invest at that level.

Mr. Maguire asked about the assumed rate of return currently at 7.5%, and Mr. Emkin said the optimal model produces a 7.3% return. The Treasurer added the 7.3% assumes 2.75% inflation, which is the current actuarial assumption used, and if the inflation assumption is reduced, the return numbers would fall as well.

Mr. Maguire asked the Treasurer if any previous Treasurer administration had done an extensive analysis of a potential mix or asset allocation. Attorney Dingley said under the Raimondo administration, there was one done.

Treasurer Magaziner said the model ran 5,000 different scenarios/stress testing. Secondly, the model shows consistently that the new portfolio is expected to perform better than the older one under almost every scenario, and thirdly, strike the balance between good returns in good years yet protecting downside on bad years. He added much time and effort was taken in this where the SIC worked diligently through this process.

Mr. Dion acknowledged Treasurer Magaziner's approach to this process. The Treasurer in turn recognized the SIC's diligence of work.

Treasurer Magaziner thanked Mr. Emkin for his efforts and presentation.

The Board recessed for 10 minutes before continuing the next report on the agenda.

Consideration of Funston Advisory Services (FAS) Board Governance Recommendations

Treasurer Magaziner thanked the Board for their efforts in working with the Funston governance study. He asked if the Rules and Regulations Subcommittee would make a specific list of recommendations to bring back to the Board, and also encouraged feedback from the Board.

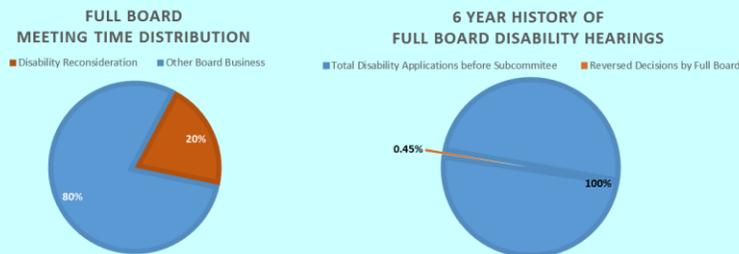
Director Karpinski began his presentation by noting that in April 2016 Funston Advisory Services (FAS) was hired based on a suggestion from Attorney Robert Klausner, who provided a fiduciary training to the Board in May 2013. In May 2016, FAS presented their initial recommendations at the annual fiduciary training at URI. FAS, with input from the Board, presented findings and recommendations for improvement in July 2016. FAS noted the current subcommittee structure is inefficient, which can present challenges to maintaining fiduciary responsibility. The Director also said that FAS recommended spending more time on key duties that pension boards commonly have responsibility for, and less time on disability adjudication.

Director Karpinski said FAS began its recommendations by noting that the Board is responsible for ALL aspects of the operation of the System, and stressed their fiduciary responsibility and RIGL§ 36-8-3, which provides that the general administration and the responsibility for the proper operation of the retirement system and for making effective the provisions of chapters 8 – 10 is vested in the retirement board.

The Director summarized the areas of responsibility where the Board should spend more time. Regarding finance, he pointed out the Board has a fiduciary duty to oversee and assist in development of the ERSRI budget, and is responsible for all expenditures. As an example of the need for improvement, he noted there is no ongoing Board review process of the Auditor General's recommendations on ERSRI financial controls. Regarding governance, the Director noted that FAS identified there was no Board approved strategic plan, no executive director performance and evaluation process, or a succession plan. For member services, FAS noted that the Board has limited input on how to deliver service, and on the priority of improvements to service delivery.

Director Karpinski said meeting time is a finite resource, and must be focused on key strategic issues facing ERSRI. He said there are risks associated with the current limited time spent on operational, legal and financial details.

The Director provided the following chart to help demonstrate the time spent on disability versus all other board responsibilities, and noted that unnecessary rounds of appeals before the full Board are overly lengthy and costly for members. Additionally, a long appeals process means members with terminal illness may pass before their spouse becomes eligible for the disability benefit:



- ✓ Over past 6 years, **out of 445 disability cases heard by subcommittee**, full board has overturned subcommittee decision only twice
- ✓ The full board only meets for about 30 hours per year. Spending this much time is inefficient and prevents the board from focusing on other critical areas

Director Karpinski said the purpose of the FAS review was to recommend ways to mitigate these risks and said a regularly active committee structure will allow the Board to provide stronger oversight and planning across key areas. Attorney Dingley said after engaging a consultant to recommend best practices, it is the Board's fiduciary responsibility to strongly consider FAS's recommendations.

Mr. Beardsley asked about the annual calendar where the Director explained the subcommittees would have an organized structure and the Board would function as a policy making body. Mr. Beardsley asked if the proposed Board structure would mean the Board meets monthly, every other month, quarterly etc. The Treasurer said options are open, but what needs to change is the current structure of monthly meetings.

Mr. Boudreau said the Board should receive copies of what FAS has provided regarding the subcommittee charters for complete review and consideration. He said then we could populate those committees and in January schedule committee meetings.

Mr. Maguire said FAS discussed a third party benchmark regarding the disability process and asked the Director to reach out to his counterparts to provide options. He also said there may need to be more time to implement the proposed committee structure. He also questioned the use of the phrase "Board inattentiveness to key ERSRI

functions” in the presentation, noting that while the Board may not review items as frequently as noted by FAS, they are not inattentive.

Mr. Rondeau wanted to know how often Disability Subcommittee votes are unanimous, and Attorney Amy Crane, the Treasurer’s Chief Legal Counsel, said 86% of votes were unanimous over the last 6 years.

Mr. Finelli asked that the Board be apprised of the time when the rules and regulations subcommittee meeting is scheduled. Director Karpinski said he would convene the subcommittee and notify the full Board.

IV. Executive Director’s Report

Director Karpinski updated the Board on the report in the Board book. He noted that the North Smithfield School Department, the East Providence School Department, Glocester Police Department, North Providence Housing Authority, Smithfield Housing Authority and the Town of Glocester are now current.

Presentation and Consideration of Fiscal Year 2018 Proposed Budget

Due to a family emergency, Finance Director Zachary Saul was not able to present the fiscal 2018 proposed budget for ERSRI thus, Director Karpinski provided the Board with the presentation. The Director began the presentation noting that R.I.G.L. 36-8-3 states the responsibility for the proper operation of the retirement system is vested in the retirement board and consistent with Regulation 1(A) 5 (10) *Board Authority and Duties*, the Board must approve a yearly budget. He said the approved Budget is part of the overall Treasury budget submitted to the General Assembly for ultimate approval. He also pointed out that since the Retirement System is a restricted receipt account, Rhode Island General Law (RIGL) §36-8-10.1 states that the ERSRI budget cap is calculated as 17.5 basis points of the average total investment assets of the system before lending activities as reported in the annual report of the auditor general for the next preceding five fiscal years.

Director Karpinski said for fiscal 2018 the average total investments before lending activities are calculated at \$7.6 billion and the budget cap (per RIGL) is \$13.4 million. He noted that in prior years the budget cap was lower. The Director then highlighted the primary budget changes for the Board as follows:

- Management of Ariel System
 - Morneau Shepell (MS) service level agreement.
 - Third party quality assurance and contract management for MS.
 - Potential Change Control Request – post implementation.
 - Data review and conversion project.
 - Integration of Ariel system and TIAA for ERSRI website.
- Legal services
 - Preliminary stage by tax counsel to review for potential IRS Qualification.
- Actuarial Expense
 - RIGL §36-10-39 – provides the general assembly the authority to request studies of the ERSRI’s actuaries at the expense of the System.

- Cost associated with accounting standards of GASB 67 & 68

Mr. Dion asked relative to the actuarial expense for FY2016 budget, \$400,000 has been budgeted, yet \$183,546 was expended. The Director said budgeted actuarial expenses also include studies that may be requested by RIGL §36-10-39 so a higher estimate is included as future legislation is unknown.

Mr. Finelli asked under the actuarial expense, would there be enough funds to do the actuarial audit. Director Karpinski noted that an audit would be scheduled for FY2019 and this type of audit is done every 7 years, and the last one was done in 2013.

Attorney Dingley asked if work related to the implementation of GASB 67 and 68 were being charged to the municipal fund, which Director Karpinski affirmed.

Director Karpinski said the legal services, specifically the *Special Counsel* for Fiscal 2018 budget is for the IRS tax qualification. The Director said the IT Services were up by \$850,000. He said this estimated cost is for a data clean-up project. He said the member services subcommittee would consider the method and cost for the project.

Mr. Dion asked about *Personnel Costs* for line *Regular Wages* why the \$150,000 increase in both FY2017 and FY2018, which the Director said related to unfilled positions.

Treasurer Magaziner apprised the Board that at the recommendation of the OAG, it was deemed necessary to add staff support in the Accounting Department. He also said next year as part of the Asset/liability study, a comparative study found that the average public pension fund between \$5-15 billion has an average of 7 investment staff, and ERSRI has only 3; it is anticipated that one more employee will be added.

Chief of Staff Patrick Marr said the personnel numbers are modeled off of what comes from the budget office which produces a file that assumes salary and calculates future benefit costs. From those numbers, Finance Director Saul builds the personnel supplement.

Mr. Maguire asked about *Security Services*, and why FY2016 was not on target. Chief Operating Officer Patrick Marr said the Capitol Police provides security to this building and that the prior officer was transferred to another location and replaced with an officer with a different tenure. He stated that pay is actual costs associated with personnel expenses related to this. Mr. Maguire asked if Treasury is the only occupant of the building, and Chief of Staff Marr said the occupancy is shared with Department of Information Technology.

Director Karpinski agreed with Treasurer Magaziner that the budget has for the most part been consistent over the years. Mr. Dion asked if a quarterly report can be provided, rather than just an annual budget notification to the Board. Director Karpinski said he will develop a quarterly report.

Director Karpinski then concluded his presentation and noted that the budget is under the cap as defined by RIGL §36-8-10.1.

On a motion made by John P. Maguire and seconded by Claire Newell, it was unanimously

VOTED: To approve the fiscal 2018 Budget as presented

Mr. Finelli reminded the Board that he and Director Karpinski were at the NCTR (National Conference of Teachers' Retirement) annual conference held at the Omni Hotel in Providence. A total of 385 people attended for a 6-day seminar. The Director

was the moderator for a Cyber Security panel, and also recognized the Treasurer for the opening speech of the seminar.

Mr. Maguire asked about Town of Foster being 17 periods past due, and the Director said they do not have a lot of State aid for withholding relative to the “*Report of Contributions*” delinquency for MERS.

The Treasurer noted that Central Coventry Fire District is no longer delinquent and said a check was received, including interest, from the time they had not made contributions for \$460,000.

Mr. Dion asked Director Karpinski about the Town of Johnston being 6 payments past due. Director Karpinski said consistent with the policy, this month State aid will be withheld.

Ms. Newell asked for an update with regard to the requested IRS ruling, and the Director said the response is still forthcoming.

Mr. Maguire asked about employee contributions where they have been deducted from pay checks but not received by ERSRI. He questioned why employers are using the money instead of it being in the System’s hands.

Treasurer Magaziner stepped out of the Board meeting at 11:48 a.m.

V. Administrative Decisions

None this month

VI. Approval of the September Pensions as Presented by ERSRI

On a motion by John P. Maguire and seconded by Roger P. Boudreau, it was unanimously

VOTED: To approve the September pensions as presented.

Treasurer Magaziner returned back to the Board meeting at 11:50 a.m.

VII. Legal Counsel Report

Attorney Robinson suggested that a motion would be in order for the Board to convene in Executive Session to discuss the pending litigation matters identified on the agenda pursuant to Rhode Island General Laws section §42-46-5 (a)(2).

Consistent with Rhode Island General Laws section §42-46-5 (a)(2) regarding pending or potential litigation involving the Retirement System, a motion was made by John P. Maguire and seconded by Claire Newell to convene the Board in Executive Session to discuss the *Kevin Lang* litigation matters identified on the agenda.

A roll call vote was taken to enter into Executive Session, and the following members were present and voted Yea: General Treasurer Seth Magaziner; Vice Chair William B. Finelli; Daniel L. Beardsley; Roger P. Boudreau; Mark A. Carruolo; Mark Dingley, designee for Michael DiBiase; Paul L. Dion, PhD.; Thomas M. Lambert; John P. Maguire; Marianne F. Monte; Daniel Orgel, designee for Thomas A. Mullaney; Claire M. Newell and Jean Rondeau. It was unanimously

VOTED: To convene the Board into Executive Session pursuant to Rhode Island General Laws section §42-46-5 (a)(2) to discuss the matters of *Kevin Lang v. Employees' Retirement System of Rhode Island*; W.C.C. No. 201504163, and *The Retirement Board of the Municipal Employees' Retirement System of Rhode Island*, which involve pending litigation involving the Board..

[Executive Session]

The Board thereafter convened in executive session.

[Return to Open Session]

Upon returning to open session, Board Counsel Michael P. Robinson noted for the record that one unanimous vote had been taken in Executive Session.

On a motion made by Paul L. Dion, Ph.D., and seconded by Marianne F. Monte, it was unanimously

VOTED: To exit executive session and return to open session.

VIII. 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 Friday, October 7, 2016:

Name	Membership Group	Type	Action
1. Wayne Cushman	Municipal	Accidental	Reconsideration/ The Board's 4/13/16 decision to deny member an accidental disability pension was reaffirmed.
2. Richard Delbonis	Municipal	Accidental	Postpone
3. Donald Ditusa	Municipal	Accidental	Approved
4. Janet Durfee- Hidalgo	State	Accidental	Approved @ 50%
5. Todd Evans	Municipal	Accidental	Postpone
6. David Benevides	State	Accidental	Approved @ 50%

Name	Membership Group	Type	Action
7. Peter Kokolski	Municipal	Ordinary	Approve
8. Cheryl Robinson- Roberts	State	Ordinary	Postpone
9. Joseph Apice	State	Ordinary	Approve
10. Geriann Hart	Teacher	Ordinary	Approve
11. Christopher Fee	Teacher	Ordinary	Approve
12. Michelle St. Germaine	Teacher	Ordinary	Approve
13. Beatriz Perez	State	Ordinary	Approve

On a motion by William B. Finelli and seconded by Roger P. Boudreau, it was unanimously

VOTED: To approve the recommendation of the Disability Subcommittee meeting of Friday, October 7, 2016 on items 8 and 9.

Claire M. Newell recused herself from the vote on numbers 8 and 9.

On a motion by William B. Finelli and seconded by Roger P. Boudreau, it was unanimously

VOTED: To approve the recommendation of the Disability Subcommittee meeting of Friday, October 7, 2016 on items 10 and 12.

John P. Maguire recused himself from the vote on numbers 10 and 12.

On a motion by William B. Finelli and seconded by Roger P. Boudreau it was unanimously

VOTED: To approve the recommendation of the Disability Subcommittee meeting of Friday, October 7, 2016 on items 1, 2, 3, 4, 5, 6, 7, 11 and 13.

IX. Adjournment

There being no other business to come before the Board, on a motion by John P. Maguire and seconded by Roger P. Boudreau, the meeting adjourned at 12:02 p.m.

Respectfully submitted,

Frank J. Karpinski

Executive Director