

TEACHERS' RETIREMENT SYSTEM BOARD MEETING
Montana Board of Investments Conference Room
2401 Colonial Drive
Helena, Montana
September 29, 2011

BOARD MEMBERS PRESENT:

Scott Dubbs
Darrell Layman
Kari Peiffer, Chair
James Turcotte
Jeff Greenfield
Robert Pancich

ABSENT:

None

STAFF PRESENT:

David Senn, Executive Director
Tammy Rau, Deputy Executive Director
Denise Pizzini, Chief Legal Counsel
Dan Gaughan, Accounting/Fiscal Manager
Bill Hallinan, Information Technology Manager
Will Harmon, Communications Manager

OTHERS PRESENT:

Representative Scott Reichner
Representative Matt Rosendale
Senator Ron Arthun
Charlene Suckow, MREA
Megan Moore, Legal Services Division
Rachel Weiss, Legal Services Division
Bob Vogel, MTSBA
Diane Fladmo, MEA-MFT
Ed Macdonald, Cavanaugh Macdonald Consulting, LLC
Todd Green, Cavanaugh Macdonald Consulting, LLC

CALL TO ORDER

Chairperson Kari Peiffer welcomed attendees and called the meeting to order at 8:38 a.m., in the Board of Investments Conference Room, 2401 Colonial Drive, Helena, Montana.

ADOPT AGENDA

Chairperson Peiffer asked for additions or changes to the Agenda for September 29, 2011. Finding none, Chairperson Peiffer requested a motion to adopt the Agenda.

MOTION/VOTE:

Member Darrell Layman moved that the Montana Teachers' Retirement System (TRS) Board adopt the Agenda for September 29, 2011. Seconded by Member Robert Pancich, the motion passed unanimously.

APPROVAL OF MAY 13, 2011 AND AUGUST 16, 2011, MINUTES

Chairperson Peiffer called for changes to the May 13, 2011, Board Meeting Minutes and August 16, 2011, Board Workshop Minutes. Finding none, Chairperson Peiffer requested a motion to adopt the May 13, 2011, Board Meeting Minutes and August 16, 2011, Board Workshop Minutes.

MOTION/VOTE:

Member Jeff Greenfield moved that the TRS Board adopt the May 13, 2011, Board Meeting Minutes and August 16, 2011, Board Workshop Minutes. Seconded by Member Robert Pancich, the motion passed unanimously.

PUBLIC COMMENT

Chairperson Peiffer called for public comment on Board related items. No public comments were made.

2011 REPORT FROM TRS ACTUARIES

Mr. Edward Macdonald and Mr. Todd Green noted a typo on page 38 of their presentation and handed out corrected copies of the page.

Overview of the Actuarial Process

Mr. Green and Mr. Macdonald explained Cavanaugh Macdonald's role in performing actuarial work for TRS.

Mr. Macdonald said TRS's 7.75% expected rate of return is reasonable based on an expected real return rate of 4.25%, plus 3.5% inflation. He also noted that the Montana Public Employee Retirement Administration (MPERA) also uses the 7.75% rate, and that this is lower than national average of 7.8% (some systems use 8%). Mr. Macdonald expressed confidence that 7.75% is obtainable and noted TRS's investment returns exceeded 7.75% in 6 out of the last 10 years, despite some significant downturns during the same period.

Mr. Macdonald also explained capital market assumptions, which are typically set either by in-house investment staff or external money managers, and are generally over only a three- to five-year horizon. Now when times are tough, people say 7.75% is unreachable. Yet in the last 10 years, TRS has exceeded that rate 60% of the time, and over the last 15 years, TRS averaged a 6.4% rate of return on market value assets. He noted this was despite three "historic" major economic downturns.

Mr. Macdonald commented on defined contribution proposals currently being considered in other states; noting that closing a plan does not reduce costs because active member

salaries are no longer available to pay the normal cost, yet retiree benefits and the unfunded liability must still be paid off. This greatly condenses the time for paying off liabilities to a 12-15 year period instead of 30 years. Payroll also tends to decrease, leading to reduced contributions. This combination can easily triple the cost of the plan and dramatically increase funding needs. According to a National Council of State Legislatures report, states that looked at closing defined benefit plans and switching to defined contribution plans abandoned the idea when they found the costs were too high.

Mr. Macdonald summarized how various changes in economic and demographic assumptions can affect the unfunded liability.

Asset Valuation Methods

Mr. Macdonald explained asset valuation methods under Governmental Accounting Standards Board (GASB) standards and summarized TRS's actuarial asset vs. market asset value trends over the last 17 years.

Representative Scott Reichner asked for data comparing Montana TRS to other states.

Mr. Macdonald said TRS's funded status is currently lower than the national average. He said that Montana's statutory contribution rate is lower than needed to actuarially fund the system. He would prefer that the statutory contribution rate be increased. He explained that most states don't have statutory contribution requirements at all, so rates vary from year to year or biennially based on the recommendations of the actuaries. Representative Reichner said it appears the problem isn't TRS's investment return rates, which seem good, but rather the contribution rate (which is set by the legislature) not keeping pace.

Mr. Macdonald explained that the statutory rate has not been adjusted to meet the Actuarial Required Contribution (ARC) rate over the last four years. He further explained that, rather than push the problem on to another legislative cycle, some states have phased in the required contribution rate increase over time.

Representative Matt Rosendale asked whether TRS's unfunded liabilities occurred before the market drop of 2008-09.

Mr. Senn said the 2001 market drop showed up in valuations in 2005, at which time a special session of the legislature addressed the shortfall by making payments totaling \$150 million over the next two sessions into TRS and increasing the contribution rate to the rate recommended by the actuaries. This payment and increased contribution brought TRS into actuarial soundness. However, since the 2009 market crash the contribution rate has not been adjusted as needed.

Senator Ron Arthun cited a report that showed Montana in "alarm status" for debt per capita. Mr. Macdonald said states that don't keep up with contributions have huge issues. States that keep up with the ARC stay funded, and tend to have better bond ratings.

2011 ACTUARIAL VALUATION REPORT

Mr. Green summarized the actuarial valuation findings, and gave a status update on TRS plan performance. To fund the system over 30 years, the ARC has increased from 9.96% to 13.49%, based on actuarial smoothing of gains and losses over four years. TRS's funded ratio is down to 61.53% and the amortization period has increased to 71 years. The aggregate statutory contribution rate of 9.96% from employers and 7.15% from employees is no longer sufficient to actuarially fund the system over 30 years.

Adopt the Valuation Report

Chairperson Peiffer requested a motion to adopt the July 1, 2011, Actuarial Valuation Report.

MOTION/VOTE

Member Greenfield moved to adopt the Valuation Report. Seconded by Member Turcotte, the motion passed unanimously.

REDUCING CONTRIBUTION VOLATILITY

Mr. Macdonald described Cavanaugh Macdonald's patented method for interest rate smoothing, which is intended to:

- Increase contribution rates during good economic times
- Reduce contribution rates during bad economic times
- Retain actuarial gains to offset losses
- Maintain actuarial soundness, and
- Comply with Governmental Accounting Standards Board (GASB) and actuarial standards of practice

PLAN DESIGN

Current System

Mr. Green summarized TRS's recent history based on contribution rates set in statute. In the past, the current statutory contribution rates were adequate to fund the system, but no longer do so. With current contribution rates, the system will run out of money by 2055 and become a pay-as-you-go system. TRS could return to actuarially sound footing by July 1, 2013, with a lump sum contribution of \$633 million, or an increase in the total contribution rate from 17.11% to 21.23%. Alternatively, TRS could implement a combination of reduced benefits and increased contribution rates, which could be phased in incrementally.

Two-Tier Benefit Structure

Mr. Green and Mr. Macdonald summarized the possible features of a two-tiered benefit structure, one tier for current active members and one for new hires. Such changes take effect gradually as employees covered under the current plan retire and are replaced by employees covered under the new tier.

The actuaries summarized 18 combinations of plan changes to address the funding shortfall. Some assumptions (i.e., lowering the accrual rate) reduce benefits below what employees will themselves have contributed under current required contribution rates,

while others have little effect on the unfunded liability. Cost of Living Adjustments (COLAs – known as GABAs to TRS members) are expensive and COLA reductions can have a large effect in reducing liabilities.

PRESENTATION BY THE BOARD OF INVESTMENTS

Cliff Sheets, Chief Investment Officer for the Montana Board of Investments (BOI), gave the annual required report to the TRS Board. Mr. Sheets summarized the Asset Allocation Report. FY 2011 was a great year for returns; TRS saw a \$450 million return. For FY 2012, the second quarter saw a net decline. Mr. Sheets also summarized TRS's investment performance vs. peer plans, noting TRS is in the 30th percentile, above median performance, and moving in the right direction. Recent changes to the portfolio include adding real estate as an asset class and an allocation to timberland. BOI also increased the allocation range for private equity.

Mr. Sheets summarized the economic outlook. Growth is very fragile with a 30% chance of recession for next year. Experts expect 1 to 2% growth for the second half of FY 2012. Yet consumption has not collapsed, employment is down but not crumbling, and inflation is likely to ease off (thanks in part to lower energy prices). Debt overhang on consumers has declined. Employment is down but not at collapse levels. We are entering an age of thrift rather than conspicuous consumption. Long-term returns still look favorable over the pension 30-year horizon. TRS's assumed long-term investment return rate of 7.75% is reasonable.

CONTINUATION OF PLAN DESIGN DISCUSSION

The Board continued considering two-tier options, looking at various multipliers, accrual rates, and GABA adjustments. Mr. Green and Mr. Macdonald also summarized the results of moving to a hybrid plan with a defined contribution (DC) option. Switching to a DC plan would reduce costs only if the state's contribution were less than the current 2.59% of payroll.

Plan Changes for Current Members

Mr. Green summarized the effects of options that would change plan structure for current members, including increasing contribution rates, basing the Average Final Compensation on 5 years instead of 3 years, reducing accrual rates, shifting vesting from 5 years to 10, suspending guaranteed annual benefit adjustments, and changing early and regular retirement ages.

The message is that TRS cannot stay on its current track: the status quo will not adequately fund the plan. There is no pain-free way to pay down the unfunded liability, but the costs can be shared rather than shouldered by any one group, and they can be incrementally phased in over time. This eases impacts, opens up more funding opportunities, and avoids driving active members toward early retirement.

FUNDING OPPORTUNITIES

Mr. Senn summarized the TRS Board's funding policy and asked the Board to provide direction on what to do next and how to deliver this message to members and the public.

Members said they wanted more time to consider all the information presented and how various options would affect employees, employers, retirees, and taxpayers. They deferred direction to tomorrow's meeting.

GASB EXPOSURE DRAFT

Mr. Macdonald described the actuarial requirements and impacts of the new standards pending from GASB that would require employers to include unfunded pension liabilities on their financial statements. The Exposure Drafts affect accounting only, not funding, but divorcing accounting and disclosure from funding will require two valuations, and that will increase administrative costs.

CONTESTED CASE HEARING PROCESS

Curt Drake, a Helena attorney, spoke to the Board about his potential role as counsel for the upcoming contested case hearing process concerning Mr. Walsh and the Ennis School District. Mr. Drake's role would be to act as the Board's advisor on issues the Board must rule on and to serve as case manager and presiding officer for the contested case proceeding acting on the Board's behalf. Mr. Drake also offered the option of working with his associate. The time frame from discovery through the hearing will likely carry into next spring.

MOTION/VOTE:

Chairperson Peiffer requested a motion to hire Mr. Drake as their attorney for the contested case hearing. Member Dubbs moved to hire Mr. Drake. Seconded by Member Turcotte, the motion passed unanimously.

ADJOURNMENT

Chairperson Peiffer requested a motion to adjourn until the morning of September 30, 2011. Member Layman moved to adjourn. Seconded by Member Pancich, the motion was unanimously approved.

TEACHERS' RETIREMENT SYSTEM BOARD MEETING
Montana Board of Investments Conference Room
2401 Colonial Drive
Helena, Montana
2nd Day, September 30, 2011

BOARD MEMBERS PRESENT:

Scott Dubbs
Darrell Layman
Kari Peiffer, Chair
James Turcotte
Jeff Greenfield
Robert Pancich

ABSENT:

None

STAFF PRESENT:

David Senn, Executive Director
Tammy Rau, Deputy Executive Director
Denise Pizzini, Chief Legal Counsel
Dan Gaughan, Accounting/Fiscal Manager
Bill Hallinan, Information Technology Manager
Will Harmon, Communications Manager

OTHERS PRESENT:

Representative Matt Rosendale
Charlene Suckow, MREA
Megan Moore, Legal Services Division
Rachel Weiss, Legal Services Division
Diane Fladmo, MEA-MFT
Phil Drake, Montana Watchdog
Kate Tally, MPERA
Scott Svee, Jackson, Murdo, & Grant, P.C.
Ed Macdonald, Cavanaugh Macdonald Consulting, LLC
Todd Green, Cavanaugh Macdonald Consulting, LLC

RECONVENE AND CALL TO ORDER

Chairperson Peiffer called the meeting to order.

Adopt Agenda

Chairperson Peiffer asked for additions or changes to the agenda for Friday, September 30, 2011. Finding none, Chairperson Peiffer requested a motion to adopt the agenda.

MOTION/VOTE:

Member Robert Pancich moved that the Teachers' Retirement System (TRS) Board adopt the agenda for September 30, 2011. Seconded by members Dubbs and Layman, the motion passed unanimously.

PUBLIC COMMENT ON BOARD-RELATED ITEMS

Chairperson Peiffer called for public comment on Board-related items. No public comments were made.

FUNDING OPPORTUNITIES & PLAN DESIGN DISCUSSION – CONTINUED

The Board continued the previous day's discussion of long-term funding issues and plan design. Member Greenfield suggested an outreach effort to gather input from members. A recommendation was made for staff to work with a Board subcommittee to develop a workplan. There isn't time for a Colorado-style listening tour, but TRS can use webinars, webcasts, Facebook, and other social media to raise awareness, build understanding, and gather input. TRS can do outreach at the MEA-MFT convention and MPERA Retirement Fair in October, and also include information in upcoming retirement seminars in Bozeman, Billings, Missoula, and Great Falls.

Member Dubbs emphasized being open to all input and sharing it. He suggested informing people with the Cavanaugh Macdonald materials on the funding issue and options, and then asking for input. A talking point on pension envy should emphasize that teachers have paid into their pension with a sizable amount out of their paychecks every month.

Diane Fladmo said MEA-MFT is standing by to help get the proper information out.

The message must be clear and specific. Concerns were raised about creating confusion and worry among the members and retirees if the TRS Board doesn't present a specific, well-developed proposal. Board members agreed that the message is critical, but that TRS members and other interested parties should be heard. They suggested presenting a structured statement of the problem, describing the most viable options (setting aside options that we know won't work, and asking "What do you think we should do?" The goal is to develop recommendations and/or a proposed bill, including consideration of member and other stakeholder comments and suggestions, for legislative consideration in 2013.

EXECUTIVE DIRECTOR'S REPORT

Mr. Senn said he will ask to address the State Administration Veterans Affairs Committee at its October 20, 2011, meeting to summarize the Board's direction on funding and the 2011 Valuation.

Executive Summary

Mr. Senn summarized data on membership average age and years of service. He noted that Melissa Michalk left for a paraprofessional school position. A new administrative

assistant will start in October. TRS staff is scheduled to do retirement seminars around the state in October and webinars and webcasts into November.

LEGAL COUNSEL REPORT

Ms. Denise Pizzini summarized the situation regarding the Attorney General's final opinion on the release of information about TRS retirees. The AG found that retirees' names and benefit amounts are public information, and retirees' privacy interests do not outweigh the public's right to know.

Scott Svee, attorney with Jackson, Murdo, and Grant, represents a TRS retiree and takes exception to the AG opinion. His client's concern is that the AG fails to recognize 39 years of monthly employee contributions. He provided a copy of a Michigan case with a dissent he believes correctly describes the privacy interests of public employees with respect to their retirement benefit amounts. He believes any release of information should clarify how much money the employee contributed over his or her career to fund the benefits he or she receives.

Board members voiced concerns about abuse of the information and what other requests for information might arise due to the opinion. Ms. Pizzini clarified that TRS always has and will continue to look at information requests on a case-by-case basis. Some information—for example, social security numbers, beneficiary designations, etc—is not within the scope of this AG opinion, and is not and will not be disclosed by TRS. Ms. Pizzini indicated the AG opinion is controlling law unless it is overturned by a state district court or the Montana Supreme Court, and that the Board could instruct TRS staff to comply with the AG opinion or authorize her to file a declaratory judgment action in state district court to challenge the AG opinion.

Phil Drake, with Montana Watchdog, said the news service requested the information to enable citizens to be informed regarding the functioning of their government.

Member Dubbs indicated he thought the Board should take more time to consider the issue. The Board instructed staff to notify retirees and active members of the AG's opinion prior to their next consideration of the matter.

MOTION/VOTE:

Member Dubbs moved to table this issue until the next Board meeting. Seconded by Member Turcotte, the motion passed unanimously.

NAPPA Conference

Ms. Pizzini briefed the Board on the annual National Association of Pension Plan Attorneys (NAPPA) conference she attended in June. Sessions focused on the future of public pension plans, including legislative initiatives to amend pension plans for new hires, existing members, and retirees, and the litigation on-going in several states based on contract rights assertions. Conference topics also included current and anticipated proposals for federal legislation to address public pension design, financial reporting, and

concerns for transparency, including the Public Employee Pension Transparency Act (PEPTA).

In another session, Mr. Keith Brainard (director of research for the National Association of State Retirement Administrators) said that public defined benefit plans will be scrutinized in upcoming congressional tax reform efforts. Any outcome of the congressional “supercommittee” is uncertain at this time. There may be proposals to modify pension tax-exempt status.

One session addressed the question of balancing trustees’ fiduciary duty to maintain a pension system with contractual obligations when considering plan design modifications. Actuaries say once it’s clear that you’re taking contributions from people you can’t pay benefits to, your fiduciary obligations expand and become clearer. The prevailing thought from attorneys is that these are *all* fiduciary obligations and they must be weighed.

This year’s litigation session focused on the lawsuits in Colorado, South Dakota, and Minnesota.

Case Updates

Ms. Pizzini said oral arguments in the Mavencamp case were made in mid-July, and there is still no decision from the court. A 90-day wait is not unusual.

OTHER BUSINESS

Board of Investments Review

Member Jim Turcotte briefed the Board on recent Board of Investments (BOI) activities. BOI has a new chairperson, Gary Buchanan, and four other new board members. The board is also reviewing nominees for a new executive director.

Regarding the markets, the floor appears to be about 1120 on S&P and probably a maximum of 1380 on S&P.

GFOA Conference Report

Ms. Tammy Rau said she attended a Government Finance Officers Association (GFOA) class on social media, which TRS can use to get ownership and buy-in among members. Texas is heavily engaged in Facebook, twitter, blogging, and other social media and found it very helpful, particularly for responding quickly to breaking issues. MPERA is on Facebook and finding that members are using it well.

Meeting Dates

The Board agreed to meet next on November 18, 2011. The following dates will be on the next agenda for Board discussion and approval: February 3, May 11, September 28, and November 16, 2012.

Financial Statement & Budget Reports

Mr. Dan Gaughan summarized the Comprehensive Annual Financial Report (CAFR), noting that Central Accounting at the Department of Administration is still working

through the information. The Investment section looks a little different. Mortgages have gone to zero because BOI moved them into another class. BOI did the same with real estate.

Reported wages went up \$5.5 million, a small increase last year compared to previously. The net increase in assets was almost \$451 million. Mr. Gaughan also summarized the budget status reports for 2011. TRS used budget carry over for equipment purchases. Contracted services showed an \$11,000 cost for our programmer. He completed some projects ahead of schedule. For the first two months of current FY, the budget request decreased by a net of \$18,000. A budget amendment will likely be needed to cover the costs of the funding issue workplan and outreach effort.

CLOSED MEETING

Executive Session to Discuss Disability Applications

Chairperson Peiffer directed the meeting to be closed at 12:05 p.m. to discuss and review disability applications, citing the applicants' right to privacy, which clearly exceeds the merits of public disclosure.

OPEN MEETING

Chairperson Peiffer reopened the meeting to the public at 12:17 p.m..

Applications for Disability Retirement Benefits

Chairperson Peiffer requested motions to approve or disapprove the disability applications.

MOTION/VOTE:

Member Pancich moved to approve Agnes Oelkers' disability request. Seconded by Member Layman, the motion passed unanimously.

Member Dubbs moved to disapprove David Culbertson's disability request. Seconded by Member Turcotte, the motion passed unanimously.

ELECTION OF OFFICERS & COMMITTEE ASSIGNMENTS

Chairperson Peiffer requested nominations for the election of Chair and Vice Chair.

NOMINATIONS/VOTE:

Member Greenfield nominated Kari Peiffer for Chair. Seconded by Member Dubbs, the nomination passed unanimously.

Member Pancich nominated Darrell Layman for Vice Chair. Seconded by Member Turcotte, the nomination passed unanimously.

Board Subcommittee and Appointments

Board members accepted appointments to subcommittees as follows:

Budget/Audit: Members Pancich and Turcotte
Legislation/Litigation: Members Greenfield and Dubbs
Personnel/Policy: Members Peiffer and Layman

Member Pancich also volunteered to help on the legislation/litigation subcommittee.

ADJOURNMENT

Chairperson Peiffer requested a motion to adjourn.

MOTION/VOTE:

Member Layman moved to adjourn the meeting. Seconded by Member Pancich, the motion passed unanimously.

Chairperson_____

Executive Director_____