

Meeting Minutes
DEPARTMENT OF LABOR EMPLOYEES' RETIREMENT BOARD MEETING
Kneip Building, Conference Room 3
Thursday, Oct. 6, 2016 at 10 a.m. CDT

The South Dakota Department of Labor Employees' Retirement Board (SD DOL ERB) met on October 06, 2016. DDN locations were in Aberdeen, Rapid City, Watertown, and Sioux Falls.

Members Present: Bob Riter, Jason Dilges, Marcia Hultman, Mike O'Brien, and Jim Reeve

Present in Pierre DDN: Emily Ward, Tom Hart, Derek Gustafson, Paula Zellmer, David Fee, and Michael de Leon

Present at Sioux Falls DDN: Sara Garbe and Dale Bendewald

Present at Aberdeen DDN: Sharon Schnabel, Betty Likness, Sharmie Jensen, Deb Gardner, Marge Walker, Betty Weber, Ray Siegle, Peggy Jeschke, and John Bender

Present at Rapid City DDN: Marcia Miller and Dennis Coull

Present at Watertown DDN: None

Chairman Riter called the meeting to order, and roll call was taken by Derek Gustafson.

June 02, 2016 Meeting Minutes: Mike O'Brien MOVED to approve the minutes for the June 02, 2016 ERB meeting and was SECONDED by Jason Dilges. MOTION CARRIED.

Opening Remarks by Chairman Riter: The goal of the meeting was to review the plan and determine if the Board needs to make any modification relative to the determination and approval of the Cost of Living Adjustment (COLA). The Board allotted time during the meeting for plan participants to share general thoughts on the issue.

Business: Deloitte – Michael de Leon

On-Demand Model Projecting:

Per the request of the Board, Deloitte prepared an on-demand model for projecting the COLA. The model Deloitte developed allows the Board to adjust the variables used in determining the COLA. These variables include: the assumed discount rate, assumed rate of return, COLA awarded, and settlement date. The current valuation assumes a discount rate of 5%, an annual rate of return of 6.5% and an annuity purchase date of 2034. The 10-year history of biweekly ranges of annuity discount rate shows the discount rate has been below 5% since 2010. The 5 year average has been between 2.99% and 3.25%. Currently the discount rate is approximately 2%. If Deloitte used a 3% discount rate while using the assumed rate of return of 6.5% and an annuity purchase year of 2034, the plan would not be able to provide any COLA for the next two years and would be able to buy annuities with a 3.5% COLA in 2028.

Michael de Leon asked Board members to provide scenarios they would like to see. Jason Dilges requested the following scenario: 6.5% rate of return, 3% discount rate, and giving zero COLA. Using these variables the plan would be able to purchase

annuities with a 3% COLA between 2024 and 2025. The next scenario requested had the following variables: using 0% return for 2016 and 5% annual rate of return thereafter, 3% discount rate, and an annuity purchase date of 2024. Using these variables, the plan would not be able to pay any COLA for eight years.

Michael de Leon pointed out that currently their actuarial analysis is formula driven. Deloitte would be able to provide the on-demand model in an addendum or to replace the formula driven method in their actuarial report. This would allow the Board to approve a COLA based on results of the on-demand model during the spring meeting.

Principal – Paula Zellmer and David Fee

Investment Strategy Discussion – Mature Plans:

Principal recommended moving from active management to passive management, which is common with plans getting close to maturity. The passive management strategy would be replacing the midcap and small cap managers with S&P's midcap and small cap indexes. Changing to a passive management strategy would cut investment expenses in half (roughly 40 basis points). David Fee stated the passive management is where they would like to see the plan eventually move to, but there is no immediate rush to make the change. Jason Dilges and David Fee both agreed now would not be the best time to switch to passive management. Principal will monitor market conditions and let the Board know when they feel the opportune time will be to make the change from active management to passive management portfolios.

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Derek Gustafson: Presented the Board with a strategy for gradually adjusting the discount rate from 5% to 3%. This strategy would involve grading down the 5% by 25 basis points each year until it reached 3% in 2024. Based off of Deloitte's presentation (p. 10), gradually lowering the discount rate would allow the plan to award between 1% and 1.5% COLA for the next 7 years. After 7 years, the COLA would begin to increase at a greater rate each year until it reached the 3.5% mark in 2029. These projections assume a 6.5% annual rate of return. In regards to the planned assets, lowering the discount rate to 3% would increase the target for the planned assets to increase from \$70.9 million to approximately \$88 million (increase of 24%).

Tom Hart: Outlined the legal procedures necessary when modifying the Plan. Currently, the Board has the option to either approve the COLA provided by Deloitte's Actuarial Report or give no COLA. The Board would need to make an amendment to the plan if they wanted to have the discretion to award something other than those two options. Under Administrative Rules 47:10:0301 the board has the ability to amend the plan and must provide the planned members a 20-day notice. The Board then has to approve it. The Board would not need to make any amendments to the Plan if they decide they wanted to change the variables used by Deloitte in their evaluation. For example, if the Board wanted Deloitte to use an assumed 3% discount rate and an assumed 5% rate of return, they would not need to make an amendment to the Plan.

Plan Member Open Forum – Discuss Possible Ideas to Manage the Plan Goals:

No discussion during open forum.

Board Discussion:

James Reeve stated the Board has two options in front of them. One involves amending the Plan so the Board has the authority to choose a COLA between zero and the recommended COLA provided by Deloitte's Actuarial Report. The other option is to reevaluate the variables Deloitte uses in their actuarial report to determine the recommended COLA. Jason Dilges showed concern with using an assumed annual rate of return of 6.5%. He requested Principal to provide an assumed rate of return specific to DOL's plan using the specific asset allocations within the plan and their corresponding rate of return using a 10 year horizon. Jason Dilges recommended the Board look at the actuarial assumptions and make changes to the variables based on the information provided by Deloitte and Principal regarding assumed rate of return and assumed discount rate with a measure of conservatism. Michael de Leon requested, if possible, for Principal to provide a 10 year assumed annuity discount rate. David Fee and Paula Zellmer were not sure if Principal had this assumption and would look into it. Michael de Leon explained the process for determining the variables used in the actuarial report are to provide Emily Ward with the variables for approval. When Deloitte sends their next request for approval, they will use the assumed rate of return Mr. Dilges requested from Principal. Emily Ward asked the Board if they would want another open forum for planned members at the next Board meeting. Mike O'Brien requested if we do have a future open forum for planned members that we have it at the beginning of the Board meeting. The Board encourages members to provide any feedback via email, phone, or mail. If members want to participate at the next meeting, the Board will provide them an opportunity at the beginning of the meeting. Members should contact Derek Gustafson if they have any questions or comments regarding the Plan or their benefits. Derek Gustafson's contact information can be found on the SD DOL ERB website. Members can also contact their nearest SD DLR local office and request their inquiries to be forwarded to Derek Gustafson.

New Business: South Dakota Department of Labor and Regulation (DLR) central office will be moving out of the Kneip Building. The new address for the Department will be 123 W. Missouri Ave. The move should be complete by the end of October.

DLR will be launching a new website Dec. 1, 2016. During this transition, DLR has also updated the content on the SD DOL ERB website. We encourage members to visit the new site once it launches.

James Reeve MOTIONED to adjourn and was SECONDED by Mike O'Brien. MOTION CARRIED at 12:44 p.m.