

NHRS Board of Trustees
Minutes-June 9, 2020

Note: These minutes from the June 9, 2020 Public Session were approved and executed at the July 14, 2020 Board of Trustees meeting.

**Board of Trustees
June 9, 2020
Public Minutes**

**New Hampshire Retirement System
54 Regional Drive
Concord, New Hampshire 03301**

The NHRS office was closed to the public as a result of COVID-19 and the meeting was held via video conferencing. Pursuant to RSA 91-A, all votes were by roll call.

Participating: Trustees Tim Lesko, Chair; Scott Christensen, Christopher Coates, Melvin Friese, Sue Hannan, Bill Hart, Benjamin Jean, Maureen Kelliher, Robert Maloney, Monica Mezzapelle, Scott Myers, Donald Roy and George Walker.

Staff: George Lagos, *Executive Director*; Tim Crutchfield, Esq., *Chief Legal Counsel*; Larry Johansen, *Director of Investments*; Gerard Murphy, *Director of Finance*; Mark Cavanaugh, Esq., *Associate Counsel & Compliance Officer*; Diana Crichton, Esq., *Hearings Officer*; Frank Clough, *Director of Information Technology*; Nancy Miller, *Director of Member Services*; Nancy Cone, *Internal Auditor*; Marty Karlon, *Public Information Officer*; Rosamond Cain, *Human Resources Manager*; Nina Calkins, *Process Improvements Manager*; Cecile Merrill, *Project Manager*; and Margaret Astles, *Executive Assistant*.

Guests: David Kausch and Heidi Barry of GRS, and Kevin Leonard of NEPC.

Chair Lesko called the June 9, 2020 regular meeting of the NHRS Board of Trustees to order at 10:00 a.m. Chief Legal Counsel Crutchfield took roll call attendance noting that all Trustees were present and alone. Having established a quorum, Chair Lesko called for a motion to accept the May 12, 2020 meeting minutes. On a motion by Trustee Hart, seconded by Trustee Maloney, the Board voted unanimously to accept the May 12, 2020 minutes as presented.

Chair Lesko provided the Audit Committee report, noting that the Committee reviewed the Audit Issues Tracking report and the status of the FY 2020 Internal Audit Plan. The Committee was joined by Plante Moran auditors to discuss the FY 2020 audit, which will commence after June 30. The Committee also reviewed and approved the FY 2021 Internal Audit Plan.

Trustee Roy reported that the Governance Committee met on May 12 to review the revised Weapons Policy. Staff noted that the revised version included input from Trustees and asked that the Committee review the Weapons Policy, in anticipation

of Committee action at its June 9 meeting. The Committee will be meeting today at the conclusion of the Board meeting when it will discuss the revised Weapons Policy, the 1099 RFP vendor consideration, and the annual renewal of cyber insurance coverage.

Trustee Kelliher reported on the May 29, 2020 IIC meeting, noting that the Committee discussed liquidity requirements for benefit payments over the next 30 to 90 days. The Committee then discussed the effects of COVID-19 pandemic on cash flow and asset allocation. The Committee voted to renew the U.S Large-cap Equity Investment Management Agreement with LSV Asset Management through June 30, 2022 and to extend the Non-U.S. Core Equity Mandate with LSV Asset Management through September 2022. The Committee heard presentations from Non-U.S. Core Equity Managers Causeway Capital and Artisan Partners in conjunction with the two-year contract renewal process. Lastly, Trustee Kelliher congratulated Trustee Lesko on his appointment as Board Chair.

Director of Investments Johansen reported on the summary investment performance through April, noting that fiscal year to date, NHRS marketable assets are down just under 5%, adding that May performed positively. As always, NHRS is looking for positive performance at the end of the fiscal year on June 30. Mr. Johansen then reported on the Asset Class Targets vs. Actual Allocation as of April 30, noting that non-U.S. equity is at 14.9% of the portfolio, just below the low end of the range. By May 31, it had climbed above the low end of the range, showing that the markets have self-corrected and at this point NHRS does not have to engage in rebalancing. He then turned the Board's attention to NHRS' performance relative to Universe Peer Rankings, noting that NHRS is in the top third fiscal year to date. Over a trailing three-year period, NHRS ranked in the top 25th percentile, over five-years NHRS ranked in the 12th percentile, and over seven-years, NHRS ranked in the 15th percentile, commenting that while markets continue to struggle, relative to peers, NHRS is doing very well. The IIC will meet on June 19, and Townsend will review the real estate portfolio and where NHRS stands relative to goals set. In addition, NEPC will present a detailed review of NHRS' private equity/private debt portfolio and make recommendations for mid-course corrections, if any. Mr. Johansen encouraged the Trustees to attend the June 19 meeting via WebEx, as real estate, private equity private debt account for 25% of NHRS assets. If Trustees wish to attend, Mr. Johansen asked that he be notified so he can send the attendees a meeting packet.

Trustee Myers began his Legislative report by thanking Mr. Karlon who has regularly provided updates on the Legislature's activities, as it has not been meeting regularly due to COVID-19. Mr. Myers noted that there are six bills related to NHRS that are active in either the House or the Senate and went on to describe their present status. He noted that HB 1326 requiring the IIC to post their quarterly investment expenses on the NHRS website will be consolidated with HB 1234 and included in omnibus legislation.

Trustee Walker reported that the Benefits Committee has not met since before the May Board meeting, but a meeting is scheduled for June 30.

For the PPCC report, Trustee Hart began by offering his congratulations to Trustee Lesko on his appointment as Board Chair. He noted that the PPCC last met on May 26. An update on staffing requirements for the contact center was provided by Human Resources Manager Cain. She suggested that most or all of the positions in the contact center would likely be filled with internal candidates because of the knowledge and the experience requirements of those positions. The PPCC then went into non-public session to discuss compensation matters related to those staff members not included in the collective bargaining unit. Lastly, Trustee Hart noted that while the PPCC typically addresses the Executive Director's compensation at the June Board meeting, this year the matter would be addressed in July.

Chair Lesko noted that the Board would be addressing several important agenda items at today's meeting, including the adoption of the Actuarial Experience Study, action on demographic and economic assumptions, and a proposed adjustment to the medical subsidy margin. He advised that action on the assumptions will impact the unfunded liability and the financial burden it carries. More than two-thirds of all employer contributions are allocated to paying down the unfunded liability while the remaining third is allocated to funding normal costs. The Board is responsible for properly funding the trust through constant monitoring of economic conditions and the impact of the efficacy of the actuarial assumptions that are employed to determine the funding. Chair Lesko reported that the Board engaged GRS to undertake an experience study a year earlier than had been done in the past to assure that any changes would be implemented on a timely basis, as a six-year gap between adjustments is not realistic. Today's proposed adoption of a new rate of return will have a direct effect on the funding of the pension trust, unfunded liability, and ultimately on employer contribution rates based on sound actuarial valuation and practice as set forth in New Hampshire's constitution as well as NHRS' policy.

At the Chair's request, Mr. Lagos described the due diligence materials which had been provided in advance to the Trustees to assist in their preparation for today's discussion, including the GRS experience study, capital market projections from NEPC and others, recommendations from the IIC and staff, assumed rates of return for over 130 public pension plans, financial models of the potential impact on employer contribution rates, fiduciary duties of Trustees, and relevant provisions from the Board's Investment and Actuarial Funding policies.

Chair Lesko then introduced David Kausch of GRS who briefly summarized the Actuarial Experience Study, the range of recommendations previously presented to the Board, and their impact on the unfunded liability and funded ratio.

On a motion by Trustee Hannan, seconded by Trustee Hart, the Board voted unanimously to adopt the GRS 4-year Experience Study for the period July 1, 2015 through June 30, 2019 as presented.

Chair Lesko asked Mr. Kausch to speak to the demographic assumptions. Mr. Kausch provided an overview and noted that the assumptions were presented for consideration as a single recommendation. Chair Lesko asked for a motion and on a motion by Trustee Kelliher, seconded by Trustee Hart, the Board voted unanimously to adopt the proposed demographic assumptions as set forth in the GRS 4-year Experience Study for the period of July 1, 2015 through June 30, 2019, as presented.

Chair Lesko then asked Mr. Kausch to summarize GRS' recommendation for the economic assumptions and the assumed rate of return. Mr. Kausch referred to sections of the Experience Study which analyzed capital market projections provided by 14 investment consultants. GRS concluded that an assumed rate of return between 6.25% and 7.0% would be considered reasonable, and their recommendation was 6.75% or something less than that. Trustee Hannan asked how the proposed range affects municipalities and school districts, because as the assumptions are lowered it will have an even more profound effect on those already feeling the pinch of the COVID-19 pandemic. Mr. Lagos indicated that information had been provided to illustrate the impact of a range of possible changes in the assumed rate of return on employer contributions. Trustee Hannan indicated she could not support anything less than a 6.95% assumed rate of return.

Chair Lesko introduced Kevin Leonard of NEPC. Mr. Leonard began by noting that NEPC provides asset allocation modeling and the annual NEPC market forecasts, annually publishing both 10 and 30-year market forecasts comprised of over 65 underlying asset classes as well as total return, risk, and volatility assumptions. NEPC's expectation is that we would see lower growth and inflation expectations generating declining overall return expectation. In applying the underlying asset class assumptions to the NHRS investment policy, the expected rate of return for NHRS on a 10-year outlook is 6.02%, and 7.18 % over a 30 year horizon.

IIC Chair Kelliher provided the Board the IIC's recommendation, noting that after a thorough review and much deliberation, the IIC recommended an assumed rate of return of 6.50%, made in light of forecast returns of long term capital markets that continue to decline as prospects for future economic growth both domestic and global have fallen. Over the last two decades, interest rates have fallen along with economic growth and international interest rates have been negative for several years. Additionally, along with the financial crisis and recent pandemic, it has added to the debt burdens of the developed world. With full understanding of the ramifications of its recommendation, the IIC believes it is prudent to lower the expectations of future economic growth, and therefore future investment returns.

Mr. Lagos then provided the Board the NHRS' staff recommendation of 6.75%. He commented that setting an assumed rate of return is not a precise science as no one is capable of predicting future investment performance for any given time period. He stated that a selection at 6.75% would be consistent with the range of

reasonableness put forward by GRS, the requirements of the NH Constitution and statutory law and the fiduciary duties of the Board.

At the request of the Chair, Trustee Hannan moved the adoption of an assumed rate of return of 6.75%. Following a second by Trustee Christensen, discussion ensued. Trustee Myers noted that he appreciated and fully supports the recommendations of our professionals, and fully understands his role as a fiduciary and Trustee. He expressed concern over the downward pressure that is being placed on municipal budgets across the state, and that payroll growth assumptions will be driven down. He suggested an assumed rate of return of 6.95%.

The Chair called the vote and on a 10 to 3 vote the Board adopted proposed economic assumptions as set forth in the GRS 4-year Experience Study for the period July 1, 2015 through June 30, 2019 as follows: Wage Inflation Assumption of 2.75% for Employees, Police, and Fire, and 2.25% for Teachers; Price Inflation Assumption of 2.00%; and Assumed Rate of Return Assumption of 6.75%.

Mr. Kausch then turned the Board's attention to the medical subsidy discussion. He noted that by policy, the margin at the end of every year should generate enough money to pay 20% of the annual medical subsidy benefit. GRS recommended increasing the margin to 50% for the Teachers' account due to past negative history, and to continue the existing medical subsidy margins at 20% for State Employees, Political Subdivisions, and Police/Fire.

On a motion by Trustee Maloney, seconded by Trust Hart, in accordance with the recommendations of the system's actuaries, the Board voted unanimously to:

- o Revise the methodology for calculating the medical subsidy margin for all member accounts;
- o Increase the medical subsidy margin from 20% to 50% for the Teacher accounts only; and
- o Continue with the existing medical subsidy margin of 20% for all other member accounts.

Mr. Lagos gave his Executive Operating report, noting that Key Performance Measures scored 94.05%, slightly under the 95% target. He noted that staff continues to work primarily from home and that NHRS has been extremely fortunate to date as no employee has fallen ill to COVID-19. He noted that NHRS is taking a slow and prudent approach to returning staff to the office. Lastly, Mr. Lagos noted that the FY 2021 Strategic Plan has been incorporated into action plans for direct reports beginning July 1, 2020.

Project Manager Merrill provided the Board an update on the PGV3 upgrade, noting that the project is 25% complete and Deliverable 2-Employer Reporting is 48% complete. User acceptance testing is starting in mid-August and the LRS team is working on putting remote training support in place in case the LRS travel ban is not lifted.

Chief Legal Counsel Crutchfield gave his legal report, beginning with an update on the Alexander Scott Supreme Court case, noting that the NHRS response filing is due on June 23. On May 13, there was a second filing for a discretionary appeal with the Supreme Court but staff has not received any notice of acceptance or denial. Mr. Crutchfield went on to note that Plante Moran provided us with a list of 22 employers for which we will be conducting GASB audits very soon.

Finance Director Murphy reported on the NHRS Financial package beginning with the FY 20 net position of \$8.8 billion at the end of April, which has improved over the March net position of \$8.4 billion, but down slightly from April of last year which was at \$9.0 billion. Cash flows are as expected for both the month and year to date. The contribution income differential shown between April 2019 and April 2020 is due to the fact that April 2019 was a 3-payroll month for many NHRS employers. Mr. Murphy reported that Finance has not seen any COVID-19 related impacts to contribution payments. The Budget vs. Actual reflects that NHRS remains under budget. Mr. Murphy mentioned that the finishing touches are being put on the announcement to employers that NHRS will be discontinuing the lock box and replacing it with Quickpay, its online payment tool. NHRS is looking at July 1, 2021 for the changeover in order to ensure that employers have ample time for the transition. Finance has shown a slight improvement in meeting its KPMs over last month but still fell short this month, as the Finance team was waiting for reporting information from two employers.

Mr. Murphy then turned the Board's attention to the FY 2021 Trust Fund Budget proposal and noted that the budget amounts have not changed since those presented last month. He summarized that the FY 2021 proposal totals \$40.1 million, which is \$3.5 million lower than the FY 2020 adopted budget at \$43.6 million. The decline is driven by lower investment management fees, partially offset by smaller increases within other areas of the trust fund budget.

On a motion by Trustee Hart, seconded by Trustee Mezzapelle, the Board voted unanimously to approve the Fiscal Year 2021 Trust Fund Budget, as presented.

Director of IT Clough reported on the recent ProofPoint spam filter upgrade to the enterprise version of the product which provides a full suite of security enhancement and protection. The Cisco telephone upgrade will be taking place this weekend. Lastly, IT has decided to migrate the managed services operation center for monitoring our infrastructure from Tyler Technologies to Secureworks by the end of the month.

Director of Member Services Miller reported that the July filing period has closed and staff is processing and calculating the 696 applications received. Member Services is preparing to roll out the monthly COLAs that begin in July. Lastly, Member Services did not meet the phone tracking KPM this month as Member Accounts was short staffed.

Chair Lesko introduced the Consent Agenda. On a motion by Trustee Myers, seconded by Trustee Roy, the Board voted unanimously to accept the Consent Agenda, as presented.

Executive Director Lagos reported that Action Items are progressing as expected.

Chair Lesko stated that he is honored to be chosen for the role as Chair of the Board of Trustees and thanked everyone for their assistance with his first meeting.

Mr. Lagos thanked Chair Lesko for a job well done at today's meeting. He then thanked the Board for diligently reviewing all of the materials for the Experience Study and thanked David Kausch of GRS and Kevin Leonard of NEPC for their assistance throughout the process.

Trustee Hannan introduced a point of order, asking to reconsider the vote on the economic assumptions, proposing a change in the assumed rate of return from 6.75% to 6.95%.

On a motion by Trustee Hannan, seconded by Trustee Myers, the Board, unanimously voted to reconsider the prior Board action adopting an assumed rate of return of 6.75%.

Following discussion, Trustee Hannan moved to adopt an assumed rate of return of 6.95%. The motion was seconded by Trustee Myers and failed on an 11 to 2 vote.

With no further business to be discussed, on a motion by Trustee Hart, seconded by Trustee Christensen, the Board unanimously voted to adjourn the meeting.

Respectfully submitted,

Margaret M. Astles, Executive Assistant