MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
MAY 17, 2017

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, May 17, 2017 at 9:00 a.m., in the Conference Room, 124 West Capitol, Little Rock, Arkansas. Mayor Morris presided.

QUORUM PRESENT:

Mayor Morris recognized the presence of a quorum.

BOARD MEMBERS PRESENT:

Mayor David Morris, (City Employee), *Chair,* Searcy, AR
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Judge David Hudson, (County Employee), Fort Smith, AR
Mr. Steve Faris (Retired State Employee), Little Rock, AR *(arrived late)*
Mr. Daryl Bassett (State Employee Member), Sherwood, AR
Ms. Candace Franks (State Employee Member), Little Rock, AR
Hon. Andrea Lea, (Ex-Officio Member), State Auditor
Mr. Larry Walther, (Ex-Officio Member), Department of Finance and Admin.
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Mr. Dennis Milligan, (Ex-Officio Member), State Treasurer

VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Ms. Brianne Weymouth, Callan Associates, Inc.
Mr. David Hoffman, Gabriel Roeder Smith and Company
Mr. Mita Drazilov, Gabriel Roeder Smith and Company
Mr. Paul Louthian, Department of Finance and Admin.
Dr. John Shelnutt, Department of Finance and Admin.
Mr. Skot Covert, State Auditor's Office
Rep. Johnny Rye, Joint Legislative Retirement Committee
Rep. Clint Penzo, Joint Legislative Retirement Committee
Mr. Roger Smith, Lobbyist
Mr. Marc Watts, AR State Employees Association
Mr. Josh Curtis, Association of Arkansas Counties
Mr. Mike Wickline, *Arkansas Democrat-Gazette*

STAFF PRESENT:

Mr. Jay Wills, APERS Deputy Director
Mr. Carlos Borromeo, APERS Chief Investment Officer
Ms. Susan Bowers, APERS Associate Director of Investments
Mr. Jason Willett, APERS Chief Financial Officer
Ms. Jessica Middleton, APERS General Counsel
Ms. Allison Woods, APERS Director of Benefits Administration
Mr. John Owens, APERS Internal Auditor
Ms. Becky Walker, APERS Director of Operations
Ms. Linda McGrath, APERS Administrative Specialist

NEWS MEDIA NOTIFIED:

A letter of notification of the Arkansas Public Employees Retirement System Board meeting was sent to the Arkansas Democrat-Gazette, the Associated Press, Television Station KLRT/FOX16, Radio Station KARN, and Radio Station KAAY. This letter of notification is pursuant to A.C.A 25-19-101 (Act 93 of 1967) as amended-The Freedom of Information Act.

WELCOME NEW MEMBERS:

Mayor Morris introduced Mr. Steve Faris, former General Assembly member from Little Rock, Mr. Daryl Bassett, current Director of Arkansas Workforce Services from Sherwood, and Ms. Candace Franks, Arkansas Bank Commissioner from Little Rock. They replaced Mr. Artee Williams, Mr. Bill Gaddy and Ms. Ouida Wright. Ms. Stone introduced key APERS Staff.

MINUTES:
Prior to the Board meeting, copies of the Minutes from the 2016 Trustee Educational Seminar, January 17th Special Meeting and February 15th Quarterly Meeting were mailed to each APERS Board member for review. Mr. Bassett motioned to accept the Minutes as presented. He was by seconded Mr. Walther and the Minutes were approved.

WHY ARE WE HERE – Presented by Ms. Gail Stone, APERS Executive Director
Ms. Stone gave a quick presentation detailing the duties and responsibilities of the APERS Trustees as Fiduciaries of the retirement system. She reviewed the general cycle of the four regular, quarterly board meetings and described the highlights of the Annual Trustee Educational Seminar held every October. Mayor Morris strongly urged all the Trustees to attend.

ACTUARIAL INFORMATION – Presented by Mr. David Hoffman and Mr. Mita Drazilov of Gabriel Roeder Smith and Company
Mr. Drazilov introduced himself and Mr. Hoffman to the new board members and discussed the assumptions that GRS had previously used to produce the 2016 APERS Valuation. He explained that even though the Trustees had reduced the Investment Return Assumption to 7.50% at the August 2015 meeting, the actuaries had warned them at that time they were likely to return and ask for a further reduction. The Investment Return Assumption had far and away the largest effect on the Actuarial Valuation for APERS than any of the other assumptions.

Actuarial 101 Pension Basics:
Mr. Hoffman began by detailing what the actuarial valuation process is, why it is performed annually and what is the purpose behind it. He explained the differences between DC (Defined Contribution) plans and DB (Defined Benefit) plans, like APERS. Mr. Drazilov noted that both types of plans carried risk; with a DC plan, the member assumed the risk and a DB plan, the bulk of the risk rested with the employer. There was no way to eliminate the risk, only to transfer it.

According to actuarial mathematics, benefits and expenses are paid from contributions and investment income, and in the long run, they usually balance out. Contributions are based upon the actuarial calculations using approved assumptions about the future and the methods used to allocate contributions over a member's lifetime. The actuaries reminded everyone that starting July1, 2005, all new State Employees contributed 5% of their pay into APERS along with their Employer's contribution. Other methods of bringing the plan back in balance would be to change the benefit provisions, but GRS was not advocating that at this time.

Mr. Hoffman explained "present value" of promised retirement benefits and how it got closer to actual cost as the time got nearer to actual retirement. He explained that if the plan was to close today, payments would still be owed for about 100 years into the future. The Unfunded Actuarial Accrued Liability (UAAL) is nothing more than the difference between the Actuarial Accrued Liability and the recognized assets of the plan. It is a measure of how well actual experience has stacked up against expectations. It is possible for it to be a negative number, as it was in the 1990s, when investment returns exceeded expectations. Over the last 15 years, the investment returns have not kept up with expectations, thus creating the UAAL. He noted that benefit payments exceeded contributions into the plan last year by $175 million, however this was not unexpected. Investment income is expected to make up the difference in a fully mature plan such as APERS.

While it has been calculated that the normal cost to the employer is only 10.8%, the additional costs are due to the UAAL being financed over a specified number of years, much like a mortgage. APERS is obligated maintain relatively a constant employer contributions from generation to generation. Since investment returns can be extremely volatile, it is customary to smooth the gains and losses of a 4-year period. Currently, APERS has $400 million investment losses yet to be recognized. From the June 30, 2016 Valuation, APERS' Funded Ratio was at 80%, based upon the UAAL of $1.9 billion. Most of these losses occurred during 2008-2009 (the Great Recession) and the plan is still trying to recover. Amortizing that $1.9 billion over 21 years adds an additional 7.24% to the employer rate for a final rate of 14.75%.

Mr. Hoffman explained what actuarial assumptions were and how they were factored into the Annual Valuation. The assumption that had far and away the largest impact on the annual calculation was the Investment Return Assumption. In 2001, the majority of the public pension plans used 8.0% as an Investment Return Assumption. For 2018, the median public plan is using 7.5% or less as their Investment Return Assumption. Mr. Drazilov urged the Board to focus on the downward trend rather than the actual numbers. Based upon Capital Market expectations from Callan and other investment consultants that GRS monitors, he recommended the APERS Trustees adopt a lower Investment Return Assumption.

(Mr. Hoffman, Ms. Lea and Ms. Bevis left the meeting at this time. Mr. Skot Covert took Auditor Lea's place at the table.)

Economic Assumptions Study:
Mr. Drazilov explained that no single set of assumptions are suitable indefinitely and reviewing them every 5 years is normal practices. APERS is due to have its 5-year review performed this fall, but the assumptions need to be reasonable for each annual valuation. He stressed that with the decline in the capital market expectations, it would be prudent for the Trustees to adopt an investment return assumption lower than the current 7.5% for GRS to us for the 2017 Annual Valuation. He discussed how the Great Recession of 2008-2009 had affected various market classes. The drop in asset values during this time period was a significant factor in the unfunded accrued liabilities being at their current level.

He discussed how the Actuarial Standards of Practice (ASOP) No. 27 dictated how economic assumptions should be selected. The foremost principle is to establish a funding level that is fair from generation to generation. Mr. Drazilov noted that currently APERS uses the following economic assumptions: 2.50% for price inflation, 3.25% for wage inflation and 7.50% for investment return. He felt that while the price and wage inflation assumptions were still valid, the investment return assumption needed to be reduced.

Based upon APERS' current Target Asset Allocation, future expectations of eight investment consultants, including Callan, were analyzed. They projected a range from 7.15% to 6.31% over the next 30-year time period. If APERS maintained its 7.5%, Mr. Drazilov felt that it only had a 35% chance of achieving that investment return on any one year. The preferred investment return in the actuarial community would hit its objective 50% of the time. Based upon the results of their analysis, the actuarial preferred investment return assumption would be 6.50%, based upon a price inflation assumption of 2.50%. Given the current investment return assumption of 7.50%, he also presented 6.75% and 7.00% as alternate investment return assumptions for the Board's consideration. Mr. Drazilov commented that under these circumstances it would be reasonable for the Board to consider lengthening the amortization period of unfunded actuarial accrued liabilities (UAAL) from 21 to 30 years to mitigate the increase in the computed employer contribution rate and he led the Trustees through the various results below.

State and Local and General Assembly - 30-Year Amortization Period				
	Current Assumption	Proposed Economic Assumptions		
Amortization Period (years)	**21**	**30**	**30**	**30**
Amortization Period for New Assumption AAL (years)	**N/A**	**30**	**30**	**30**
Investment Return Assumption	**7.50%**	**7.00%**	**6.75%**	**6.50%**
Wage Inflation Assumption	**3.25%**	**3.25%**	**3.25%**	**3.25%**
Employer Contribution Rate				
Total Normal Cost	10.80%	12.12%	12.83%	13.64%
Member Contribution Rate*	3.29%	3.29%	3.29%	3.29%
Employer Normal Cost	7.51%	8.83%	9.54%	10.35%
Unfunded Actuarial Accrued Liability	7.24%	7.37%	8.04%	8.72%
Total Employer Rate	**14.75%**	**16.20%**	**17.58%**	**19.07%**

**weighted average*

Mr. Drazilov reminded the Board that earlier in the year, he had brought some suggested benefit changes before the Trustees and showed the savings that each would have upon the system. He stated that GRS was not advocating any solutions in question, but conveying to the board that barring any changes in benefit provisions, this is a better reflection of the funding requirements of the system because of lowered investment return expectations going forward.

Several members expressed gratitude and appreciation for the actuary's hard work. Judge Hudson commented that his take-away from the presentation was not "doom and gloom" but rather a sense of urgency to get something done in a responsible fashion. Ms. Stone asked the board members their thoughts on asking employers to pay 16.20% or 17.58% for their employees. She stated that even at the current rate of 14.75% there were employers grumbling that APERS was too expensive. She proposed adopting a one-year rate of 7.15% for the actuaries to use for the 2017 Valuation. Mr. Drazilov calculated that figure would result in a 15.37% employer rate (using a 30-year amortization period). She said that in the meanwhile Staff would seek to find alternative asset allocations and other de-risking strategies, and asked the Trustees to seriously consider altering the COLA feature of the plan. If that was legislatively done, there would be an immediate savings that would take the near-term pressure off the employers. Mr. Drazilov agreed, based upon when the benefit provision actually went into place. Ms. Stone acknowledged that this was not an optimal solution, but rather an incremental solution get the fund in a more stable position where they were not continually looking to employers to cover the shortfall.

Judge Hudson requested actual numbers (city, county and state payrolls) so trustees could gauge the financial impact of their decision making on employers and so employers would know how to best balance their budgets.

Mr. Drazilov reminded the Board that the numbers in the above chart were based upon the year-end figures from 2016 and could change substantially depending on how the market ends on June 30, 2017.

Several trustees expressed concern about making such a critical decision without having adequate time to study these numbers. Mr. Drazilov stated that the pressure to select an Investment Return Assumption was simply so the actuaries had a starting point to conduct the June 30, 2017 Actuarial Valuation. If the Board needed further time to study the numbers to get comfortable with the information, then the Actuaries would not be able to provide a tentative 2019 Employer Rate is August so that Cities and Counties could begin to plan their budgets. Ms. Stone suggested that since the Employers were already set to pay 14.75% for July 1, 2017, if the Board approved the temporary (one-year) rate of 7.15%, Staff would bring them more information over the upcoming months so the Board had a greater understanding when they had to revisit the issue a year from now. This would most likely result in a ~15.0% employer rate, but that was entirely dependent on how the market returns finished out the fiscal year; right now the market returns were looking very good.

Ms. Stone stated that she was sympathetic towards all the new members being asked to make sure an important decision at their first meeting and offered that a special meeting could be held in mid-June, at the latest, to give them time be become comfortable with their decision. Meanwhile, the Actuaries could work with the 7.15% number to perform their Valuation.

After additional discussion, Judge Hudson motioned to come back in June for a special meeting to decide on the Actuarial figures. Mr. Bassett seconded and the motion passed. There was a lengthy discussion regarding what further information the Trustees were seeking and when everyone would be available for the special meeting. Ms. Stone reiterated that the Board could still approve the 7.15% today so the Actuaries could perform the Valuation. Over the summer Staff would then get the information and figures from the Municipal League and Association of Counties about what the impact of a real reduction in return would have on the local entity budgets.

There was further discussion regarding the escalating employer rates, actuarial timelines and standards of practice. It was concluded that there would be no new information to contribute to the discussion in a mere 2-3 weeks that warranted coming back for a special meeting and whatever employer rate the actuaries came back with would not be implemented until July 1, 2018. Mr. Faris motioned to rescind the previous motion and adopt the one-year 7.15% Investment Assumption with a 30-year amortization period. Judge Hudson seconded. Motion passed.

QUARTERLY REPORT FOR THE PERIOD ENDING MARCH 31, 2017 - Presented by Mr. Ryan Ball & Ms. Brianne Weymouth of Callan Associates, Inc.

Mr. Ball gave a synopsis of the previous quarter from an economic and market perspective. Good returns for equities, both domestic and international, made for positive numbers for the quarter.

Actual Asset Allocation was close to Target Allocation with the small overweight in Domestic Equity and slight underweight in Fixed Income due to market movement.

The Fund returned 4.60% for the quarter and 11.03% over the trailing 12-months, putting it in the top-half of similar-sized funds.

Ms. Weymouth explained how to read the Callan Manager Performance chart and detailed the asset classes' returns.

Manning & Napier – This manager had been experiencing some organizational changes. They had dropped one portfolio manager and that coupled with their weak returns, warranted keeping them under a close watch.

Small Cap Value Manager Search
Mr. Ball reminded the Board that they had terminated Lombardia and placed their money in an Index Fund. Callan's search had returned with 6 potential replacements for APERS Small Cap Value search. He recommended funding the new manager with $200 million, with the additional funds to be pulled from

- AllianceBernstein
- Boston Partners
- Chartwell Investment Partners
- Dimensional Fund Advisors LP
- LSV Asset Management
- Rothschild Asset Management Inc.

Mr. Ball discussed the pros and cons of each of the potential candidates. After a short discussion, Judge Hudson motioned to ask for presentations from Boston Partners and LSV Asset Management at the August meeting. Ms. Franks seconded the selections and the motion carried.

(Mr. Walthers left the meeting at this time and Mr. Paul Louthian took his place at the table.)

Draft Amendments to Board Regulations
Since the meeting was running long, Ms. Stone asked to move this item up on the agenda while there was still a quorum to vote on the following item. She explained that these new regulations were to assist with COMPASS (APERS new pension administration plan) and to comply with recently passed legislation.

- Regulation 103 – EMPLOYER CONTRIBUTION RATES
  This was merely to codify what the retirement system had already been doing for years.

- Regulation 104 – EMPLOYER REPORTING
  Ms. Stone noted that APERS had gone live with the new pension administration system on March 20, 2017 and as of April 25 there was 100% compliance with all 740 employers reporting electronically. This is much more secure and economical for all involved.

- Regulation 201 – AGE OF MEMBER – HOW ESTABLISHED

- Regulation 214 – DROP PROVISIONS
  Ms. Stone explained that many members were electing to take lifetime monthly payments of their DROP accounts. She recommended changing "lifetime" to a 25-year term. This applied ONLY to the DROP payments and members would continue to collect their regular monthly retirement payment.

- Regulation 215 – SPOUSE'S ACKNOWLEDGEMENT OF BENEFIT SELECTION

- Regulation 220 – TERMINATION OF COVERED EMPLOYMENT

- Regulation 222 – RECOUPMENT OF OVERPAYMENTS
  This new legislation was a result of an audit finding that the agency had been lax in the collection of overpayments. Ms. Stone explained that this problem occurred since APERS

pays out benefits on the first of each month. If a retiree dies midway through the month, the agency is required to collect the benefit back. With this regulation, there is now a specific and well laid out process to collect these overpayments in the future.

Mr. Bassett motioned to approve all the new and amended Board Regulations and was seconded by Mr. Faris. Motion carried.

Trustees were given a handout that gave a summary of the retirement legislation that had passed during the last General Assembly session.

SUMMARY OF RETIREES FOR MARCH , APRIL & MAY 2017:
Ms. Stone stated that the numbers just kept increasing as more and more Baby Boomers retired.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING MARCH 31, 2017:
The Fund had a value of $7.82 billion at the end of APERS' third fiscal quarter. Over the last nine months, APERS has paid out over $400 million in benefits to retirees and beneficiaries. Ms. Stone estimated that APERS was on target out pay out roughly half a billion dollars in benefits for Fiscal Year 2017.

OTHER BUSINESS
Legislation Update – Interim Study
Ms. Stone discussed a letter from Osborn & Carreiro (actuaries for the Legislative Retirement Committee) that had been written at the urging of Rep. House and Senator Hester for them to conduct an interim study on the Defined Benefit Plans in Arkansas. The study would start with the two smallest systems: Arkansas State Police Retirement and Judicial Retirement (both of which are managed by the APERS Staff). Later the study would expand to examine APERS and ATRS. Ms. Stone will keep abreast of the details and pass them along to the board members as they became available. Mayor Morris asked to be notified of any future dates so that he and other board members could attend those meetings.

Mr. Faris spoke out strongly about this study to possibly move the Arkansas retirement systems to move the plans from- Defined Benefits to Defined Contribution and felt that all APERS members needed to be aware of this and attend the meetings, if possible. The result of this study could greatly impact people's benefits and they needed to know about this from the beginning. He asked Mr. Watts to spread the information to all his members. Judge Hudson commented that Arkansas does not have the same history and track records as many of the other state plans listing in the accompanying article.

Litigation Update – Presented by Mr. Jay Wills, APERS Deputy Director
Mr. Wills distributed the latest updates regarding the four nursing home cases. He gave a quick synopsis of the cases for the benefit of the new board members and explained that in three of the cases it was determined that the employees did not qualify to be members in APERS and had never presumed to be members. Judge Gray reversed the APERS board's decision by ruling that any of the three conditions needed to be met, not <u>all</u> of the conditions, as the statute appears to require. Mr. Wills felt that this should be an easy reversal on appeal, but it would be difficult to get all the 7000 pages of the record abstracted properly. If Judge Gray's decision stands, both Craighead and Lawrence Country will be hard pressed to come up with the funds to remit to APERS on behalf of these "members", some of which date back to 1961.

On the Woodruff County case, Judge Bell came to the opposite conclusion on the same basic facts and dismissed the action. In addition, Mr. Wills noted that the opposing side had delayed filling their statutory record with the Supreme Court and missed their deadline. He expected that appeal to be dismissed in the next day or so.

COMPASS Update
Ms. Stone was happy to report that in the 6 weeks since the "go-live" date, APERS was now enjoying 100% electronic reporting compliance by all the employers. While there had been a few bugs found, the developer was still on-site and working hard to get all the fixes in place. There had been a soft roll-out to the members and Ms. Stone commented that the participation was higher than expected at the member self-service portal. Mayor Morris complimented the APERS web page and encouraged everyone to go check it out.

Callan College Dates
Ms. Stone pointed out the handout that detailed the two upcoming Callan College dates and locations and strongly urged all the trustees to take advantage of the educational opportunity.

Financial Report Query
The trustees were polled as to if they wanted various quarterly reports and if they wanted it electronically or hard copy.

Ex-Trustees
Mayor Morris requested that Ms. Stone direct Staff to write the 3 departing Trustees letters of thanks for their service to the APERS Board and recognize their valuable contributions. Serving on the board is a challenging position but the decisions made here impact the lives of thousands of Arkansans.

NEXT QUARTERLY BOARD MEETING:
The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, August 17, 2017 at 9:00 a.m.
Annual Trustee Educational Seminar is scheduled for Tuesday, October 24, 2017 *(all day)*.

ADJOURNMENT:
There being no further business, the meeting was adjourned.

David Morris
MAYOR DAVID MORRIS, CHAIR

Gail H. Stone
MS. GAIL STONE, EXECUTIVE DIRECTOR