

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES  
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM  
MAY 18, 2016**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, May 18, 2016 at 9:00 a.m., in the Conference Room, 124 West Capitol, Little Rock, Arkansas. Mr. Williams presided.

**QUORUM PRESENT:**

Mr. Williams recognized the presence of a quorum.

**BOARD MEMBERS PRESENT:**

Mr. Artee Williams (State Employee Member), *Chair*, Maumelle, AR  
Ms. Ouida Wright (State Employee Member), *Vice-Chair*, Conway, AR  
Judge David Hudson, (County Employee), Fort Smith, AR  
Mr. Bill Gaddy (State Employee Member), Little Rock, AR  
Mayor David Morris, (City Employee), Searcy, AR  
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR  
Hon. Andrea Lea, (Ex-Officio Member), State Auditor  
Hon. Larry Walthers, (Ex-Officio Member), Department of Finance and Admin. (*arrived late*)  
Ms. Gail H. Stone (Executive Director), APERS

**BOARD MEMBERS ABSENT:**

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

**VISITORS PRESENT:**

Mr. Ryan Ball, Callan Associates, Inc.  
Ms. Brianne Weymouth, Callan Associates, Inc.  
Mr. Mike Knapp, Legislative Audit  
Mr. Jeremy Hutchinson  
Mr. Josh Curtis, Association of Arkansas Counties  
Mr. Ben Katon, Kernodle & Katon Investments  
Mr. Jeff Kernodle, Kernodle & Katon Investments  
Ms. Darlene Yountz, APERS Member  
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. 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 KAAZ. This letter of notification is pursuant to A.C.A. 25-19-101 (Act 93 of 1967) as amended-The Freedom of Information Act.

**MINUTES:**

Prior to the Board meeting, a copy of the Minutes from the February 17<sup>th</sup> meeting was mailed to each APERS Board member for review. Ms. Lea motioned to accept the Minutes as presented. She was seconded Mr. Gaddy and the Minutes were approved.

**ANNOUNCEMENTS BY THE DIRECTOR:**

Ms. Stone announced that she had recently received notice from the Governor's Office that Mayor David Morris had been reappointed to the APERS' Board for another 6-year term. She also stated that earlier in the week, she had decided to promote Mr. Jay Wills to the position of APERS Deputy Director effective May 1<sup>st</sup>. APERS has begun looking for a new Chief Counsel to fill the now-vacated position left by Mr. Wills.

**QUARTERLY REPORT FOR THE PERIOD ENDING MARCH 31, 2016 - Presented by Mr. Ryan Ball & Ms. Brianne Weymouth of Callan Associates, Inc.**

Mr. Ball gave a brief overview of the investment climate during the first quarter of 2016. He noted that the stock markets followed the price of oil down during the first half of the quarter, but then beginning February 11<sup>th</sup> through the end of the quarter, stock prices rose. Bonds rallied as interest rates dropped almost 0.5% though the quarter. Outside the U.S., developed markets struggled during the quarter despite the weakened dollar, while Emerging Markets were up over 5%.

APERS' Asset Allocation continued to be largely in-line with the Target Allocation.

The total fund returned 0.92% for the quarter, beating out its benchmark by 42 basis points. Over the trailing 12-months the Fund has underperformed its benchmark, returning (1.82%). Ms. Stone observed that through April, this number had been pared down to (1.2%) and she was hoping to get to zero by the end of the fiscal year.

Ms. Weymouth detailed several managers' performances.

- **Lombardia** – their style was back in favor and they had great outperformance. Holding fast to their strategy has paid off.
- **Wellington** – notable underperformer during the past quarter; excessive bank holdings hurt their performance.
- **Manning & Napier** – excellent performance this quarter returning 3.49%.
- **Horrell** – returned 5.56% over the quarter, handily outperforming the S&P 500 index. Mr. Ball noted it was difficult to find a benchmark to judge the niche portfolio against.

**Investment Manager Organizational Developments**

**Invesco** - announced in March that David Farmer, Global Chief Operating Officer, will retire in March 2017. The transition is expected to have minimal impact on the investment side of their business as Farmer is not a member of any of Invesco's investment committees. The process to replace Farmer was initiated about nine months ago when he first informed Invesco executives of his plans. The firm requests that all senior executives provide at least one year notice prior to any retirement for transition purposes.

**Manning & Napier, Inc.** – announced the retirement of CEO Patrick Cunningham due to "personal reasons unassociated with his role" at the firm, effective April 18, 2016. Cunningham spent the past 24 years with the firm and was appointed as CEO in June 2010. Cunningham will serve as an advisor for the next three months. As a result this announcement, Manning & Napier is establishing an Operating Committee, which the firm was operated under prior to the 2011 IPO, to manage the responsibilities of the office of the CEO.

*(Mr. Walther arrived at this time)*

**MacKay/Pareto Partners Update**

Mr. Ball gave a brief history of how the two individual Fixed Income portfolios had been hired by APERS and later merged. Initially, they had functioned as two distinct and separate investment strategies, but with the retirement of MacKay's original manager, Mr. Gary Goodenough, in 2012, the distinctions have become blurred and the two portfolios correlate too closely. Between those two mandates, MacKay Shields holds 11.1% of APERS total assets or roughly \$800 million and Callan felt it would be prudent to diversify the Fixed Income portfolio further. Callan suggested the Board replace the legacy MacKay Core+ portfolio.

Mayor Morris motioned to follow Callan's recommendations and begin a search for a new Fixed Income manager and he was seconded by Mr. Gaddy. Motion was adopted. Mr. Ball explained the standard search process for the new board members and the Trustees discussed various timelines for interviewing perspective managers.

**SUMMARY OF RETIREES FOR MARCH, APRIL & MAY 2016 :**

Ms. Stone observed that APERS never had fewer than 125 retirees each month and this month was no exception with 153 new retirees for the month of May.

## **FINANCIAL STATEMENTS FOR THE QUARTER ENDING MARCH 31, 2016:**

At the end of March, APERS' total assets were valued at \$7.259 billion. Ms. Stone commented that as of mid-May, the value had increased to over \$7.3 billion. APERS has paid out almost \$365 million in benefits in the first nine months of Fiscal Year 2016 and is on track to pay roughly \$450 million before July 1; a new high-water mark for the system.

## **OTHER BUSINESS:**

### **Securities Litigation Counsel Update – Presented by Mr. Jay Wills, APERS Deputy Director**

Mr. Wills distributed copies of a District Court Opinion and Order filed April 14, 2016 with the Western District of Arkansas. In it, Judge P.K. Holmes expresses his displeasure with a group of lawyers pursuing class actions in his court and what he identified as a pattern and practice of misconduct. Mr. Wills projected a timeline of events for the hearing and probable appeal for the seventeen litigation attorneys, both plaintiff and defendant, accused of abusing the Court process in an effort to maximize their attorney fee recovery over the recovery for the class members they were supposedly representing. Two of the eight firms that APERS currently has on retainer are involved: Kiel Goodson in Texarkana (which had both Matt Kiel and John Goodson named) and Kessler Topaz in Pennsylvania (Matthew Mustokoff). Mr. Wills commented that this was very disturbing as these firms had a fiduciary duty to the retirement plan and he felt it was of utmost importance to APERS to keep abreast of this case. Neither firm was currently representing APERS in any litigation, although both had in the past.

### **Litigation Update – Presented by Mr. Jay Wills, APERS Deputy Director**

The only ongoing litigation APERS was currently involved with centered on the nursing home administrative appeals the Board had listened to last summer. The three cases on appeal in Pulaski County were still waiting to be addressed by the Circuit Court. There has been no decision and Mr. Wills stated he believed the appeal briefs were due to be filed by mid-June and APERS' shortly thereafter. No oral arguments had been requested at this time and he expressed cautious optimism that the case would be decided in APERS' favor.

The other nursing home appeal had been filed in Woodruff County. The judge in that case, in response to motions filed by the defendants, struck paragraphs 12-87 of the appellant's complaint and is treating it purely as an Administrative Appeal. Mr. Wills had recently met with the assigned representative from the Attorney General's office and they had reviewed the case. APERS' Brief is due shortly after Memorial Day. He remained optimistic that the case would be decided in APERS favor, especially after the Judge eliminated 90% of the Plaintiff's argument and given the judicial deference given to a Board's interpretation of their own law.

### **Biennial Budget Request – Presented by Ms. Gail Stone, APERS Executive Director**

Ms. Stone stated her biennial budget requests were modest and distributed a one page handout detailing her requests. Starting at the bottom, she explained APERS needed the Board to approve a 24% increase (\$150 million) to the direct deposit appropriation to cover the increased number of retirees the plan currently supports.

The second request was for a net increase of \$10,000 in the Capital Outlay to purchase a new Server, 2 new high-speed scanners, and a high capacity printer to work in tandem with the new COMPASS computer system due to come online in less than a year.

Finally, Ms. Stone asked the board to approve 9 position upgrades to staff also tied to the new pension administration system. She requested that 3 Fiscal Support Specialists (C112) be upgraded to Fiscal Support Analysts (C115) and 6 Fiscal Support Specialists (C112) be upgraded to Retirement Analysts (C116). This would result in a net increase of \$37,416 to payroll and combined with the \$10,000 in Capital Outlay requested previously, a 0.27% increase to APERS' existing budget.

Ms. Bevis motioned to accept the Director's budget request and was seconded by Ms. Wright. Motion passed.

### **Appeal of Denial of Service Credit – Ms. Darlene Younts**

Mr. Wills distributed the exhibits that would be referred to during the appeal and introduced Ms. Darlene Younts. He outlined the Hearing Process that the Board would follow and asked Ms. Younts, for the record, if she had any objections to the form or location of the hearing. She did

not. Mr. Wills pointed out that the hearing was being recorded and a verbatim transcript would be available, should it be required.

Staff's position is that it is a question of law and that question is: Did the Board have the authority to adopt a regulation in 1994 that fleshed out the definition of an employee who would be entitled to state retirement membership. Until 2001, the statute only contained a limitation on membership for employees who worked less than 90 days. APERS' statute contained the added part-time restriction that mandated employees work at least 80 hours per month before they were eligible to be APERS members.

Ms. Younts was recognized by the Board and she explained her view of the case. She detailed the pro rata credit for employees working less than 80 hours a month: 40-60 hours were credited with a half month, while 20-40 were credited with a quarter month's service. Less than 20 hours did not accrue any service credit. Ms. Younts stated she had worked 16 hours per week (~64 hours monthly) for two years and assumed she was receiving state credit for those hours.

When she got to her present job, she was informed she has no credit with the state for the period in question, because APERS didn't recognize less than 60 hours monthly. She felt that there was a legislative intent to give employees retirement credit and she should be given APERS credit for those hours worked. Ms. Younts opined that APERS' regulation was in direct conflict with the legislative intent. She noted there had not been a law passed until 2001 that codified the Board Regulation in question. She acknowledged that the last sentence of the act gave the APERS Board the final say in who was or was not an "employee" for the purposes of retirement membership. She maintained her case should be decided on the "fewer than 90 days" requirement rather than "80 hours monthly".

When questioned, Mr. Wills admitted this was the first time this issue had come up since he'd started working at APERS in 2008. He also noted that the Board Regulation requiring the 80 hours monthly had been on file at the Secretary of State's Office since 1990. Ms. Stone added that the requirements had always been the same for all employees, regardless if they were County, City or State employees.

Ms. Lea expressed concern for areas where APERS regulations did not mirror Legislative Statutes. Ms. Stone noted that any Regulation change went through the standard promulgation process, including being approved by the Rules and Regulations Committee.

Ms. Younts argued further, reading from §24-4-301 "*Membership as condition to employment. (a) (1) Except as set forth in this subsection, all state employees..... shall become members of the Arkansas Public Employees' Retirement System as a condition of employment.*" She maintained that the only exception was for person's hired to work less than 90 days. The additional "80 hours" condition was not added by the Legislature until 2001.

Mr. Wills clarified that it took a Supreme Court lawsuit to remove the power from the Legislature to review and approve administrative agency rules. He believed this happened in 2006 and left the Legislature with authority to merely review changes. However, at the time these changes were made it was still permissible, and practiced, to review and approve.

Since Ms. Younts had nothing further to add, Mr. Wills summed up the points of the hearing for the Board members. He felt this was a permissible exercise of the Board's regulatory power as you could infer the intent of the Legislature to have APERS membership open only to full-time employees both by looking at the 90-day employee limitation, and also a preceding paragraph at the part-time limitation for the employees with the Legislature. Ms. Younts was correct that they did not include the 80-hour limitation for the next five subsequent Legislative sessions, but nor did they see fit to legislate against that statute. Their failure to react could have been from ignorance, although the changes were all on file at the Secretary of State's Office, or it could indicate the Legislature's acquiesce to the idea that APERS membership was only open to full time employees. Periods worked of less than 80-hours per month only applies to APERS members. Mr. Wills gave further cases where the Legislature could have challenged the APERS' requirements and they did not.

Ms. Stone added that the 80-hour condition for membership was not an arbitrary number, but was instituted to comply with IRS law requiring 1000 hours annually to be classified as "full-time".

Discussion continued as to how a full-time APERS member might end up working less than 80 hours a month.

Ms. Stone observed that should the Board decide in favor of Ms. Younts being awarded fractional credit for service before full-time APERS membership was achieved, then virtually every employer in APERS would have to begin providing universal coverage for every part-time employee and start paying contributions on them. Those part-time employees would also be required to contribute and she felt it would severely impact budgets across the state. Judge Hudson agreed with Ms. Stone's assessment and stressed he wanted to be fair and consistent to employees. Ms. Stone stated if the Board sided with Ms. Younts, it would provide a huge windfall to APERS at great expense to the cities and counties.

After a short discussion between Ms. Younts and Ms. Stone on the difference between Board action and Statutory law, Mr. Walther motioned to uphold Staff's position with regards to Ms. Yountz seeking retroactive membership in APERS. Second by Judge Hudson and the motion carried.

Mr. Wills explained the timeline of appeals to Ms. Younts if she decided to do so.

**Technology Project Update – Presented by Ms. Gail Stone, APERS Executive Director**

Ms. Stone expressed her gratitude for Mr. Ed Armstrong's assistance in getting APERS' contract for "data cleansing" moved along, thus avoiding a massive derailment of the COMPASS project. APERS is now back on schedule for the "go-live" date of March 12-17, 2017. She noted that the agency was still struggling with a shortage of Staff due to the hiring freeze by Governor Hutchinson. APERS was being forced to bridge the shortage with temporary agencies and extra-help workers, at a much higher cost than hiring regular employees to fill the vacant positions.

In regards to implementation of the new system, she encouraged the city and county workshops to find time in their various gatherings to allow APERS to give a short presentation in an effort to make those who compile the monthly reports to become comfortable with the new system. Ms. Stone noted that with all the reporting cycles in the state, APERS was seeking to go-live at a time that would synchronize with the majority of the employers' payrolls.

**STAFF TRAVEL REPORT:**

The report was noted without comments.

**NEXT QUARTERLY BOARD MEETING:**

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, August 17, 2016 at 9:00 a.m.

The Annual Trustee Educational Seminar will be held October 25, 2016 at the Capital Hotel in Little Rock. AR.

Ms. Stone announced that she would be attending the annual NASRA (National Association of State Retirement Administrators) conference in Coeur D'Alene, ID from August 6-10. This year's session would be focused on Risk Management and she encouraged Trustee attendance at this very informative and educational event.

**ADJOURNMENT:**

There being no further business, the meeting was adjourned.

  
MR. ARTEE WILLIAMS, CHAIR

  
MS. GAIL STONE, EXECUTIVE DIRECTOR