

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
AUGUST 15, 2012**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, August 15, 2012 at 9:00 a.m., in the Conference Room, 124 West Capitol, Little Rock, Arkansas. Mr. Artee Williams presided.

QUORUM PRESENT:

Mr. Williams recognized the presence of a quorum.

BOARD MEMBERS PRESENT:

Mr. Artee Williams (State Employee Member), *Chair*, Director, Dept. of Workforce Services
Ms. Ouida Wright (State Employee Member), Conway, AR
Judge Mike Jacobs (County Employee), Clarksville, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Mayor Steve Northcutt (City Employee), Malvern, AR
Ms. Janet Harris, Deputy State Auditor (*proxy*)
Mr. Mike Creekmore, State Treasurer's Office (*proxy*)
Hon. Richard Weiss (Ex-Officio Member), Dept. of Finance and Administration
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Hon. Charlie Daniels (Ex-Officio Member), State Auditor
Hon. Martha Shoffner (Ex-Officio Member), State Treasurer
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR

VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Mr. Kevin Dolsen, Callan Associates, Inc.
Mr. Norm Jones, Gabriel Roeder Smith & Company
Mr. David Hoffman, Gabriel Roeder Smith & Company
Dr. John Shelnett, Dept. of Finance and Administration (*proxy*)
Ms. Trina Spear, Blackstone Alternative Asset Management
Mr. Scott Soussa, Blackstone Alternative Asset Management
Mr. Gideon Berger, Blackstone Alternative Asset Management
Mr. Paul Meister, Grosvenor Capital Management, L.P.
Mr. David Richter, Grosvenor Capital Management, L.P.
Mr. Michael Travaglini, Grosvenor Capital Management, L.P.
Mr. Tony Dote, Lazard Alternatives, LLC
Mr. Chris Heasman, Lazard Alternatives, LLC
Mr. Kit Boyatt, Lazard Alternatives, LLC
Mr. Mike Knapp, Bureau of Legislative Audit
Ms. Jessica Middleton-Kurylo, Bureau of Legislative Research
Ms. Amanda Gibson, Attorney General's Office
Mr. Danny James, Arkansas State Employee Association
Mr. Marc Watts, Arkansas State Employee Association
Mr. Jody Carreiro, Osborn, Carreiro & Associates, Inc.
Mr. Carlos Pacheco, BNY/Mellon
Mr. Michael McDermott, BNY/Mellon
Ms. Jane Strike, Hyden, Myron & Foster, PLLC
Mr. Ernest Green, Cyrus Capital
Mr. Jerry Bias, Sugarleaf Vineyards
Mr. Jeremiah Wood, Friday Law Firm
Mr. Wyckliff Nisbet, Jr., Friday Law Firm
Mr. Mike Wickline, *Arkansas Democrat-Gazette*

STAFF PRESENT:

Ms. Michele Williams, APERS Deputy Director
Mr. Carlos Borromeo, APERS Chief Investment Officer
Ms. Susan Bowers, APERS Associate Director of Investments

Mr. Jay Wills, APERS Attorney Specialist
Mr. Craig Blackard, APERS Internal Auditor
Ms. Becky Walker, APERS Administrative Service Manager
Mr. Mark Herring, APERS Accounting Operations Manager
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.

ANNUAL AFFIRMATION OF BOARD CHAIR AND VICE CHAIR:

Mr. Weiss motioned to continue with Mr. Artee Williams as Chair and Clark County Judge Mike Jacobs as Vice-Chair of APERS for another year. He was seconded by Ms. Wright and the motion passed. Mr. Williams thanked everyone for the vote of confidence and said he looked forward to a year he expected to be “filled with a lot of challenges.”

(Mr. Weiss left the meeting at this time and was replaced at the table by Dr. Shelnett.)

MINUTES:

Prior to the Board meeting, a copy of the Minutes from the meeting of May 16, 2012 were mailed to each APERS Board member for review. On a motion made by Judge Jacobs and seconded by Ms. Wright, the Minutes were approved as presented.

PRELIMINARY ACTUARIAL VALUATION FOR FISCAL YEAR 2012 – Presented by Mr. Norm Jones and Mr. David Hoffman of Gabriel, Roeder, Smith and Company

Mr. Jones began reminding the Board that the purpose of the Annual Valuation was to measure the financial progress of the fund and to recommend an Employer Contribution Rate for the upcoming Fiscal Year. Then he turned the floor over to Mr. Hoffman who reviewed the recent historical valuations for the last ten years and showed how the number of active members has grown from 42,230 (2002) to a high of 45,380 (2010). Over the past ten years, the average member’s salary has grown from \$26,320 annually to \$34,181 – this excludes district judges and General Assembly members.

During that same time period, the number of retirees and DROP participants had grown from 16,911 to 26,191 and the percentage of active payroll had also risen from 13.3% (2002) to 20.9% today and was anticipated to continue to rise. Mr. Hoffman was quick to point out that this increase was not factor in the rising Employer Contribution Rate as these benefits had been prepaid. The expected normal employer cost was just under 7% and additional costs were a result of the poor investment experience over the last ten years. Based on these figures, it was recommended that the Employer Contribution Rate be set at 14.88% beginning July 1, 2013.

Mr. Hoffman showed the development of the Funding Value of Assets and how the 4-year smoothing had buffered the market gains and losses. He noted that overall the Fund was in a much better position than 3-4 years ago and currently had more unrecognized gains than losses. Mr. Jones reviewed projected valuation results based on various market returns over the next three years. In all but the most pessimistic scenario, the Funded Ratio rose from the current 71% to 73-77% and the projected Employer Contribution Rate fell to between 13-14%.

In response to Dr. Shelnett’s question about the new GASB reporting standards and how it would affect the plan, Mr. Jones gave a quick overview of the impact on the retirement system and its employers beginning Fiscal Year 2014. Ms. Stone noted that roughly 65% of APERS’ employers are state agencies and the rest are county/city, thus only 35% of the \$2.5 billion unfunded liability would proportionally assigned to those non-state entities.

Mayor Northcutt motioned to adopt the proposed employer rate of 14.88% for FY 2014 (starting July 1, 2013). He was seconded by Ms. Harris and the motion carried unanimously.

Finally, Mr. Jones reminded the Trustees that GRS bases many of its calculations on numbers that it derives from the 5-Year Experience Study. This study was last performed on the system in 2007, so it is time for it to be done again. He and Mr. Hoffman would report back at the

February meeting with the new results and recommend possible adjustments at that time. Ms. Stone asked if it might be appropriate to adopt a more detailed funding policy at that time and Mr. Jones acknowledged that would be very appropriate to do so at that time. When asked, Ms. Stone estimated that lowering the Assumed Actuarial Rate to 7.5% would cause the Employer Contribution Rate to increase to 16-17%. Mr. Jones commented that the average Assumed Rate for most public employers was 7.75%; currently APERS assumes 8%.

QUARTERLY REPORT FOR THE PERIOD ENDING JUNE 30, 2012 - Presented by Mr. Ryan Ball and Mr. Kevin Dolsen of Callan Associates, Inc.

Mr. Dolsen noted three projects that Callan continues to work on funding the allocation to Diversified Strategies and the transition to new asset allocation targets. They will also continue working with timber managers on a transition plan to the new target allocations. Mr. Dolsen showed the current asset allocations of the fund and noted that it had returned (0.33%) for the year (Fiscal Year 2012). He pointed out that April and May had been dismal months for investors; the markets had rallied in June, but not enough to produce a positive number in the portfolio. Fixed income instruments fared far better as the 10-year US Treasury yield fell to a record low on June 1st before finishing the quarter at 1.66%. Outside of the United States, Belgium was the only country to finish with positive numbers.

The Actual Asset Allocation was very close to the Target Allocation with the exception of the Diversified Strategies portfolio which was underweight by about 2%. Mr. Dolsen explained that quarter-by-quarter there would be variation due to the market, but over a longer time period, the differences would wash out. He promised to discuss this more fully when the Board reviewed Alternative Assets during the afternoon session of the meeting.

For the Fiscal Year, the fund finished below its policy target of 2.17% with a disappointing (0.33%) return. Mr. Ball noted that much of this underperformance (58 basis points) could be attributed to funds that “couldn’t have invested” due to the recent addition of the Real Assets portfolio which has been stuck in the “entry queue” waiting for suitable properties to become available. The rest of the losses came from massive write-downs taken by NTP and losses in CastleArk’s energy portfolio.

- Stephens: turned in the best absolute return for the quarter.
- Westwood: returned (7.08%) for the quarter and underperformed the Russell 2500 by 294 basis points. This manager has been struggling over the recent quarters, but over the ten-year period, the portfolio exceeded the benchmark by more than 4% and ranked at the 3rd percentile of Callan’s Small/Mid Cap Broad Style Group.
- CastleArk: During the second quarter, both CastleArk energy portfolios trailed their benchmarks and ranked in the third quartile of their respective style groups.
- INTECH: had considerable relative outperformance and ranked in the 1st percentile of their peer group.
- AQR and Newton: posted positive second quarter returns and bested their target benchmark.
- Artisan Partners: outperformed the return of the MSCI EAFE Index by 232 basis points during the quarter and ranked at the 12th percentile of Callan’s Core International Equity Style Group. Since inception, the portfolio is nearly 8% ahead of the benchmark and ranks in the 4th percentile.
- National Timber Partners: returned (33.88%) during the second quarter. The manager elected to write-down the market value of a number of properties which secure the Fund’s notes during the quarter. The write-downs follow weaker than expected interest in a bulk sale of several of the underlying properties.

Ms. Stone noted that through the month of July and beginning of August, the fund had earned back over \$51 million.

SUMMARY OF RETIREES FOR JUNE, JULY & AUGUST 2012 :

Ms. Stone announced that it had been a record year with the APERS Staff retiring over 1700 members in the last 12 calendar months. She noted that once the “Baby Boomers” started turning 65, the number of retirees had begun a steadily upward trend.

MEDICAL REVIEW BOARD RECOMMENDATIONS:

The Medical Review Board met at 10:00 a.m. on Tuesday, August 7, 2012 in the APERS Library to discuss the five (5) cases of Ms. Juneann Cotnam, Ms. Patricia C. Long, Ms. Angela Nelms, Mr. Duncan E. Brown and Ms. Linda Gray

- After review and discussion, the Medical Review Board found that Ms. Juneann Cotnam was suffering from an illness or injury at the time of the member's termination in June 2010, which subsequently led to the disability determination.
- After review and discussion, the Medical Review Board found that Ms. Patricia C. Long was suffering from an illness or injury at the time of the member's termination in September 2008, which subsequently led to the disability determination.
- After review and discussion, the Medical Review Board found that Ms. Angela Nelms was suffering from an illness or injury at the time of the member's termination in December 2010, which subsequently led to the disability determination.
- After review and discussion, the Medical Review Board recommended the denial of disability retirement for Mr. Duncan E. Brown at this time, pending further information.
- After review and discussion, the Medical Review Board found that Ms. Linda Gray was suffering from an illness or injury at the time of the member's termination in September 2009, which subsequently led to the disability determination.

With APERS Board approval, in accordance with ACA 24-4-511(e)(3) benefits for the four recommended members will be effective September 1, 2012. On a motion made by Ms. Wright and seconded by Mr. Gaddy, the Trustees approved the Medical Board Reviews' recommendations.

2012 INTERNAL AUDIT RESULTS & PROPOSED 2013 AUDIT SCHEDULE – Mr. Craig Blackard, APERS Internal Auditor

Mr. Blackard reviewed the 2012 Internal Audit Work Schedule which consisted of thirteen (13) scheduled audit areas and one (1) special project:

- Review process for calculation DROP/PAW benefit estimates.
- Review service and salary data.
- Review of workflow of employer reporting.
- Review accounting of transactions (Domestic Equities).
- Review accounting of transactions (International Equities).
- Review accounting of transactions (Domestic Fixed Income).
- Review accounting of transactions (International Fixed Income).
- Review agency practices for verification of retiree spouse for benefits.
- Review processing of disability benefits.
- Review calculations of retroactive benefits.
- Review staff training requirements
- Review agency practices for compliance to State of Arkansas guidelines.
- Review purchasing function for segregation of duties.
- Survey of employers for compliance to Act 558 of 2011. (Special Project)

Mr. Blackard explained since all fourteen audits in the work schedule achieved their audit objectives and no audit findings were identified, he had no recommendations to make at this time. He then reminded the Board about Act 558, the results of the survey sent out to APERS Employers and the potential ramifications of their compliance. He stated that even though this was a one-time survey, he felt that an audit program needed to be developed to make sure all employees were being reported to APERS. Ms. Stone agreed that a system of spot-checks would be developed to prevent any more infringements of the law.

Mr. Blackard then detailed the 8 internal audits he planned to carry out over the 2013 Fiscal Year. They were as follows:

<u>Audit Area</u>	<u>Audit Objective</u>
Refunds of Contributions	Review process for handling employee refunds.
Refunds of Contributions	Review process for handling employer refunds.
General	Review written procedures of agency position.
Equities, Fixed Income	Review process for handling investment transactions.
Age and Service Benefits	Review process for verifying benefit calculations.
Age and Service Benefits	Review of agency practices regarding collection of required documents.
Benefit Accounting	Review of process for retiring off members.
Disability Benefits	Review process for changing benefits from disability benefits to full age and service benefits.

Judge Jacobs motioned to accept the planned 2012 internal audit. He was seconded by Mayor Northcutt and the motion carried.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING JUNE 30, 2012:

Ms. Stone noted that the system had paid out a record \$360 million in benefits to members and their beneficiaries during Fiscal Year 2012. This is approximately \$15 million more than last year and the number is expected to continue grow for the next several years as the bulk of the Baby Boomers continue to retire.

OTHER BUSINESS:

Litigation Update – Presented by Mr. Jay Wills, APERS Attorney Specialist

The first subject that Mr. Wills discussed was the on-going problem with the Montgomery County Nursing Home and their staff not being members of APERS. He explained that since the facility was established in 1991, the Nursing Home Board has always taken the view that they were the ones who decided whether or not to join APERS, and had always refused. About a year ago, two of the nursing home staff approached the APERS Board to determine eligibility and while Staff was reviewing their request, a Class Action lawsuit was filed in Montgomery County over the situation. Montgomery Nursing Home and their staff have since reached an amicable resolution. The Judge in the consent decree has made an explicit finding that Act 737 of 2011 was constitutional, and the nursing staff has never been eligible in APERS.

With that Judicial finding, it was Mr. Wills' recommendation to follow the Judge's decision and all parties in the suit were asking for an affirmative vote from the APERS' Board that this decision covers all past, present and future Montgomery County Nursing Home employees.

He noted that the two nursing home staff that had asked for a decision from the APERS' Board had withdrawn their request and as a result of this lawsuit, the employees now had a pension plan set up especially for them. The lawyers for the case were requesting an affirmative vote from the Board indicating that this matter was concluded, as far as APERS was concerned.

Judge Jacob motioned that if the consent decree provided is entered as it appears that the Board agrees to take no further action in connection with the Montgomery Nursing Home employees. Ms. Wright seconded and the motion passed unanimously.

The next litigation item dealt with Judy Danniels and the Board's decision on denying her Public Safety credit. She had appealed this decision through the Garland County court and despite her lawyer failing to file any briefs, the Judge decided to reverse the APERS Board's decision based solely upon the law that Mr. Wills' had provided. Presently her lawyer, Mr. Q. Byrum Hurst, was preparing an order and until Mr. Wills had a chance to review what the order says, he felt the Trustees should hold off pursuing any action. He noted that Ms. Danniels relied entirely on the definition of "Public Safety Officer" as it was amended, and which did not contain the "Elite Certification" requirement that the Board Regulation requires.

Regarding the pending "Double Dippers" appeal, Mr. Wills informed the Trustees that briefs had been filed and motions were pending, but currently the Court is on vacation and he opined that nothing would be done on this case until after September 1. He had checked the docket a short time ago, and nothing had shown up yet. He would keep the Board notified on any actions regarding this appeal.

Lastly, Mr. Wills detailed his recent experiences at the annual NAPPA (National Association of Public Pension Attorneys) conference regarding "Cycle C" which was instituted roughly 4½ years ago by the IRS for determining a pension plan's tax-qualified status. APERS made timely

submissions and has heard nothing back other than acknowledgements that the materials had been received. He noted that the next 5-year cycle was quickly approaching and every public pension plan with a DROP or DROP-like provision is in the same situation of just waiting until the IRS decides how to deal with this issue. Mr. Wills pointed out that the representative from the IRS hinted that this all might “go-away” depending on the difficulties that federal agency encountered.

Potential Retirement Legislation – Areas to Consider

Last month, Ms. Stone and Mr. Hoffman had a meeting in regards to other retirement systems they administer. Also at that time they reviewed potential ideas for areas that might receive attention during the 2013 Legislative session. Ms. Stone stated she was ambivalent on all the suggestions but felt the Board should review them and give GRS some direction to proceed.

Mr. Hoffman talked in general about re-designs that other states have done in the past three years. He discussed member contributions, an idea instituted by APERS almost 7 years ago and its impact on the system. He noted that in APERS the current milestone for full retirement was 28 years-of-service or age 65. Other states have or are looking at raising these to 30-32 years-of-service or age 67. Another possible change would be to the post-retirement increases. Currently, APERS retirees enjoy an annual 3% compound COLA. Mr. Jones commented that if these changes were applied to new members only; it would be many years before the system actually saw any cost savings to the plan. The Arkansas laws would have to be carefully examined to determine if any changes could be applied to currently active or retired members if the Trustees were interested in the application of any of these ideas. He noted that these actions had proven exceedingly unpopular in other states and almost always resulted in a class-action lawsuit.

Another idea on the table was to reexamine the overall benefit program and decide what is an adequate benefit for an APERS retiree, then calculate what part of that is covered by Social Security, what part is covered by member contributions in this system, what part is member savings and what part is actually covered by Employer contributions. One outcome might be a lower multiplier for future retirees.

Mr. Hoffman’s final suggestion was a total change in what share of the risk is borne by the employer versus borne by the employee; in other words, some type of hybrid plan. He then asked for guidance from the Trustees as to which, if any, the Board would like more follow-up on. Mr. Gaddy questioned what the surrounding states were moving towards and Ms. Stone admitted that would include a huge range of possibilities. Mr. Jones commented that NASRA had information like that, but it wasn’t always current. He would find out what he could and forward to the APERS Board members.

Finally, Ms. Stone pointed out that APERS was the only system in Arkansas (and one of very few in the country) that pays out benefits in advance. Currently, anyone who files in a timely fashion for retirement with the system could work through the last day of that month and receive their paycheck, then turn around and collect their retirement check on the first day of each month. This schedule results in a constant leakage of unrecoverable over-payments when retirees die mid-month and puts APERS out-of-synch with most of the other reciprocal retirement plans.

Ms. Stone’s suggestion was to utilize the additional one million dollars a month collected from Act 558 of 2012 (contributions paid on rehired retirees and DROP participants) and use that money to pay for a system-wide “13th check” that would push the actual monthly payment back one day, to the end of the month, without causing financial difficulties for the retirees. She estimated this one time, additional payout would cost the system \$26 million. Mr. Hoffman noted there would be some savings associated with this plan in reducing the overpayments to deceased retirees. Ms. Stone opined that APERS had written off hundreds of thousands of dollars over the years in unrecoverable overpayments. Such an action would require legislation as the law is specific that retirement begins on the first business day on each month, so it would have to be rewritten to say end of the month. She hoped that this could be implemented prior to completing the new Member Records Computer System for a variety of reasons.

Mayor Northcutt requested a study on the effects of using a 5-year final average salary instead of a 3- year final average. After further discussion regarding the temporary annuity Ms. Stone asked Mr. Jones to run through the list of cost saving suggestions for the Board and get some feedback

on which ones they were interested in pursuing. He pointed out that this information could be handy to show Legislators at a later date if they wanted to make changes to the system.

- Raising the employee contribution rate above 5% - NO
 - | Extending minimum service to 30 years and age to 67 |
- | Extending minimum service to 30 years and age 62 | - YES
 - | Extending minimum age to 67 with 28 years of service. |
- What benefits this plan actually provides at various plateaus - NO
- Decrease the automatic COLA for retirees - NO
- 5-year final average salary, instead of 3-years - YES
- Replacement study - YES

APERS Recent Awards

Ms. Stone announced to the Board that APERS had recently been awarded “Employer Support Freedom Award”. This award is the nation’s highest recognition given to employers for their exceptional support to their employees whom are serving in the Guard or Reserve. Governor Beebe congratulated Ms. Stone and the other employers being recognized for their support, acknowledging that the awards are small, but still a meaningful way for the military to recognize the contributions and shared sacrifices, which employers make toward our national security, through the support they show for their employees serving in the Guard and Reserve.

APERS Annual Educational Seminar – Monday, October 15, 2012

Ms. Stone reminded the Board members that the Annual Seminar would be held at the Capital Hotel on Monday, October 15, 2012. This would be a one-day event similar to last year, but without the formal dinner, however refreshments would be provided.

Staff Travel Report

The report was noted with no comments from the Board.

RECESS FOR LUNCH

FUND-OF-FUNDS MANAGER PRESENTATIONS:

- 12:30 p.m. – Blackstone Alternative Asset Management – Presented by Ms. Trina Spear, Mr. Scott Soussa and Mr. Gideon Berger
- 1:30 p.m. – Grosvenor Capital Management, L.P. – Presented by Mr. Paul Meister, Mr. David Richter and Mr. Michael Travaglini
- 2:30 p.m. –Lazard Alternatives, LLC – Presented by Mr. Tony Dote, Mr. Chris Heasman, and Mr. Kit Boyatt

After introductions, the three candidates gave a short history of their company, people, portfolio construction, transparency, compliance, due diligence, and fees. There some discussion regarding the flexibility of the proposed fees and Mr. Ball assured the Trustees that all three candidate’s fees were negotiable. Ms. Wright motioned to hire Blackstone with an initial investment of between \$120 - 125 million (2% of the portfolio) contingent on the fee negotiation. Ms. Harris seconded and the motion carried.

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, November 14, 2012 at 9:00 a.m.

ADJOURNMENT:

There being no further business, the meeting was adjourned.

MR. ARTEE WILLIAMS, CHAIR

MS. GAIL STONE, EXECUTIVE DIRECTOR