

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
NOVEMBER 14, 2012**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, November 14, 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
Ms. Janet Harris, Deputy State Auditor (*proxy*)
Mr. Wes Goodner, State Treasurer's Office (*proxy*)
Dr. John Shelnett, Dept. of Finance and Administration (*proxy*)
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Judge Mike Jacobs (County Employee), Clarksville, AR
Mayor Steve Northcutt (City Employee), Malvern, AR
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Hon. Richard Weiss (Ex-Officio Member), Dept. of Finance and Administration
Hon. Charlie Daniels (Ex-Officio Member), State Auditor
Hon. Martha Shoffner (Ex-Officio Member), State Treasurer

VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Mr. Kevin Dolsen, Callan Associates, Inc.
Mr. Norm Jones, Gabriel Roeder Smith & Company
Mr. Mita Drazilov, Gabriel Roeder Smith & Company
Mr. Mike Knapp, Bureau of Legislative Audit
Ms. Jessica Middleton-Kurylo, Bureau of Legislative Research
Ms. Erika Gee, Attorney General's Office
Mr. Paul Young, Arkansas Municipal League
Mr. Chris Villines, Association of Arkansas Counties
Mr. Marc Watts, Arkansas State Employee Association
Mr. Jody Carreiro, Osborn, Carreiro & Associates, Inc.
Mr. Zach Borromeo, student observer
Mr. Mike Wickline, *Arkansas Democrat-Gazette*

STAFF PRESENT:

Ms. Michele Williams, APERS Deputy Director
Mr. Carlos Borromeo, APERS Chief Investment Officer
Ms. Ashley McAdoo, APERS Chief Fiscal Officer
Mr. Jay Wills, APERS Attorney Specialist
Ms. Becky Walker, APERS Administrative Service Manager
Ms. Abbi Bruno, APERS Retiree Services 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 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.

SPECIAL GUEST:

Mr. Williams acknowledged the presence of Mr. Zach Borromeo at the meeting as a student observer.

MINUTES:

Prior to the Board meeting, copies of the Minutes from the meetings of August 15 and the Educational Seminar of October 15, 2012 were mailed to each APERS Board member for review. On a motion made by Mr. Goodner and seconded by Dr. Shelnutt, the Minutes were approved as presented.

ANNUAL ACTUARIAL VALUATION FOR FISCAL YEAR 2012 – Presented by Mr. Norm Jones and Mr. Mita Drazilov of Gabriel, Roeder, Smith and Company

Mr. Jones announced that they would be presenting the detailed results of the June 30, 2012 valuation. Mr. Drazilov reminded the Trustees that the two main purposes of the annual valuation are to determine the annual employer rate and the funded portion of the system. He reviewed the calculations that were used to derive the suggested Employer Contribution Rate of 14.88% beginning July 1, 2013; this is a 0.64% increase over last year. It was noted that unlike past valuations, this was the first year to roll the few remaining General Assembly members in with State and Local members.

Mr. Jones commented that APERS was extraordinarily fortunate with its investment return the previous fiscal year which had given system a slight buffer against future increases. However, the June 30, 2012 funded ratio of the plan was calculated to be 68.9%; this is down from 70.7% due mainly to investment losses in 2012.

Mr. Drazilov pointed out how one of the fundamental objectives in establishing the employer contribution rate was to maintain a level rate for year to year, to the extent that it was possible. He reviewed how APERS' rate had risen from 10% in 2002 to 14.88% this year. He opined that the Trustee's had done a "pretty good job" despite the difficult investing environment during the past 10 years, but he noted that in the struggle to keep the rate low, the actuaries had lost a key tool that they use to keep the rates stable. In 2009, the amortization period had been pushed to 30 years - the maximum time period commonly accepted. With the loss of this component, Mr. Drazilov explained, it would make the investment performance that much more critical to the stability of the fund in the upcoming years. He explained how GRS used a 4-year smoothing of recognized gains and losses in an attempt to keep a level employer contribution rate and noted that looking forward there were nothing but gains to be recognized.

The actuaries showed the recommended transfers that required the Board's approval. Mr. Drazilov noted that this was purely an accounting exercise required by statute and did not affect the valuation.

Finally, he quoted that based upon the results of the June 30, 2012 actuarial valuation, APERS continues to satisfy the general financial objective of level contribution financing. As a by-product of achieving level contribution financing, actuarial accrued liabilities usually become more and more funded over a period of years. Funded ratios in the 70% to 80% range are common in public sector retirement plans. The funded ratio of APERS has been adversely affected by the market downturn in late 2008 and early 2009 (as has virtually all other public employee retirement systems in the country). On a funding value of assets basis, the System has a 69% funded ratio. On a market value of assets basis, the System has a 70% funded ratio. Based upon experience through June 30, 2012, the State and Local Government contribution rate (including General Assembly members) will be 14.88% of covered payroll for the fiscal year beginning July 1, 2013.

Ms. Wright moved for approval of the recommended transfers and was seconded by Ms. Harris. Motion carried.

Ms. Harris motioned to approve 14.88% as the employer contribution rate for Fiscal Year 2014 (beginning July 1, 2013). Ms. Wright seconded and the motion passed.

Mr. Jones led the Trustees through a series of projected valuations based upon various market returns over the next three years. He detailed the projected Funded Value/Market Value, Employer Rates and Funded Ratio and how this could affect the System.

Mr. Williams tabled any discussion on potential retirement legislation until the February 2013 Board meeting.

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

Mr. Dolsen gave an overview of the capital markets, noting it was a positive quarter for the U.S. Equity markets and an even better one for Non-U.S. markets; Fixed Income also turned in a healthy 1.6% return. Real Estate and Hedge Funds grew by 2.34% and 3.34%, respectively.

For the quarter, the fund returned 5.59%, handily beating its benchmark of 4.77% and ranking APERS in the top 4% of its peers. Much of the over-performance came from active management, with Fixed Income managers doing a superior job. For the last twelve months, the fund had earned 19.89%

- INTECH: trailed for the quarter with a 5.68% return, but longer term they have much more favorable numbers relative to the Index.
- Lazard Asset Management: turned in a really strong quarter at 7.44%, placing them in the top 17% of their peers.
- Stephens: had really performed well over the last 2-3 year period despite the slight underperformance during the latest quarter.
- Westwood: beat 88% of their peers with a return of 32.69 for the past 12 months. Their underweight in REITs really helped this outperformance. One of APERS strongest managers.
- Blackstone: was recently funded and will appear in the next Callan Quarterly report.
- Artisan Partners: has consistently done well, returning 9.05% for the quarter and 23.39% for the trailing 12-months. These returns are an excellent example of their stock picking ability.
- CastleArk AR Energy: highest performing manager in the portfolio for the quarter, growing by 11.15%.

Mr. Dolsen explained that recently Mr. Ed Clark, one of the owners of CastleArk, had decided to retire from the firm and will be selling his shares back to his partner Mr. Jerry Castellini, who would in turn, sell some shares to the small cap growth team. Also in the news, Artisan would be going public and selling of about 20% of the shares to pay down some debt. Mr. Dolsen noted that they had made this announcement previously, but with a downturn in the market they decided to delay until the markets were more favorable.

Dr. Shelnett asked about the fund's possible overweight in energy. After a short discussion, Mr. Ball commented that Energy has been the best performing sector and most funds the size of APERS had exposure to some sort of Real Assets, even if it was structured differently. Ms. Stone added that APERS existing Energy portfolios (which comprise roughly 3% of the total fund) were taken under consideration when constructing the Blackstone Fund-of-One.

Overall, Mr. Dolsen noted, the portfolio is normally slightly cheaper than the market and has a higher earnings growth than the benchmark due to APERS' active managers. He also pointed out that it was very underweight Japan and overweight Europe and Emerging Markets.

Fixed Income Guideline change

Ms. Stone explained to the Board that Prudential, one of APERS' three Fixed Income managers (MacKay Shields, Pareto Partners and Prudential) had requested an increase in the 144A private placements from a limit of 20% to 30%. Callan and Staff had reviewed the request and felt the limit should be raised to 30% for all the Fixed Income managers with the Board's approval.

Ms. Wright motioned to raise the limit on 144A private placements from 20% to 30% and she was seconded by Ms. Harris. Motion passed.

Pinnacle Forest Timber Investments Limited Partnership Agreement

Mr. Ball reminded the Trustees they had agreed to reduce the fund's timber exposure from over \$200 million down to \$75 million. Pinnacle's new 15-year contract is very similar to their previous one and would give them the flexibility to liquidate selected assets to reach the \$75 million figure. The Board still has the ability to terminate with a 30-day notice. Mr. Dolsen added that Callan's Real Estate specialists had reviewed the contract and were very comfortable with the terms.

Mr. Goodner moved to adopt the changes to the Pinnacle Forest Limited Partnership Agreement. Dr. Shelnutt seconded the motion and it carried.

SUMMARY OF RETIREES FOR SEPTEMBER, OCTOBER & NOVEMBER 2012 :

Ms. Stone noted that since the elections earlier in the month, staff has been contacted by many elected officials who failed in their re-election bids and will be retiring on December 31, 2012.

MEDICAL REVIEW BOARD RECOMMENDATIONS:

The Medical Review Board met at 10:00 a.m. on Tuesday, November 6, 2012 in the APERS Library to discuss the case of Ms. Felecia Patterson.

- After review and discussion, the Medical Review Board found that Ms. Felecia Patterson was suffering from an illness or injury at the time of her termination in April 2008, which subsequently led to the disability determination.

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

FINANCIAL STATEMENTS FOR THE QUARTER ENDING SEPTEMBER 30, 2012:

During the last quarter, Ms. Stone announced that the fund had surpassed the \$6 billion mark earlier in the quarter, but had receded to a current Market Value of \$5.96 million. APERS paid out over \$102.3 million in benefits to its retirants and beneficiaries in the first quarter of Fiscal Year 2013.

OTHER BUSINESS:

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

The only active matter is the "Double Dipper" appeal currently before the Supreme Court which had pulled it away from the Court of Appeals where it was originally filed. This means any decision will be final within the State of Arkansas and give APERS clear guidance one way or the other. All briefs were filed in early September, but the case has not yet been submitted to the court as of November 8th. Mr. Wills was unclear why it was taking so long, but he opined that it might have to do with the fact that two of the seven Arkansas Supreme Court Judges were retiring in just over a month and been taken out of rotation.

Adopt Amended Regulation 203 – Jay Wills, APERS Attorney Specialist

Mr. Wills distributed a copy of amended Regulation 203 which allowed the Federal Railroad Retirement Board's disability finding to be used in place of Social Security in certain cases. The Board had discussed this case during the Educational Seminar in October 2012 and Mr. Wills briefly reviewed the case that had precipitated the change and asked the Trustees to approve the amended Regulation

Upon a motion by Mr. Goodner and a second by Ms. Harris, it was unanimously agreed to adopt the amended Regulation 203.

RFQ for Securities Litigators

Fiduciary duties of the Board require that they seek to recover losses by the Fund. Mr. Wills would be filing the RFQ for Securities Litigators, as well as sending an electronic copy to all Board members. Ms. Stone stated that the planned timeline would be to bring all the responses before the Board at the February meeting for the Trustees review and if any were selected as semi-finalists, a special meeting would be called for March or April to hear the candidate's presentations.

Ms. Stone's Response to Internal Audit – No Findings

Ms. Stone was happy to acknowledge that in light of the superb internal audit with no findings, her only response was that Staff was doing a great job.

Staff Travel Report

The report was noted with no comments from the Board.

Tentative Schedule for 2013 Board Meetings

The Trustees reviewed the regular dates for the 2013 Board Meetings and agreed to move the November meeting up one week to avoid the Thanksgiving holiday. The dates for the APERS Board meetings in 2013 are as follows:

- February 20, 2013
- May 15, 2013
- August 21, 2013
- October 2013 – Educational Seminar (exact date to be determined later)
- November 13, 2013

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, February 20, 2013 at 9:00 a.m. Besides the usual topics, the Board will be reviewing the latest actuarial assumptions and discussing the RFQ for Securities Litigators.

ADJOURNMENT:

There being no further business, the meeting was adjourned.


MR. ARTEE WILLIAMS, CHAIR


MS. GAIL STONE, EXECUTIVE DIRECTOR