

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
NOVEMBER 16, 2016**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, November 16, 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
Mayor David Morris, (City Employee), *Vice-Chair*, Searcy, AR
Ms. Ouida Wright (State Employee Member), Conway, AR
Judge David Hudson, (County Employee), Fort Smith, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Hon. Andrea Lea, (Ex-Officio Member), State Auditor
Ms. Autumn Sanson, (Ex-Officio Member), State Treasurer (*proxy*)
Dr. John Shelnett, (Ex-Officio Member), Department of Finance and Admin. (*proxy*)
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR

VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Ms. Brianne Weymouth, Callan Associates, Inc.
Mr. Brett Cornwall, Callan Associates, Inc.
Mr. David Hoffman, Gabriel Roeder, Smith & Company
Mr. Mita Drazilov, Gabriel Roeder, Smith & Company
Mr. Philip Barach, DoubleLine Fund
Mr. Ryan Hart, DoubleLine Fund
Ms. Barbara Ziegler, DoubleLine Fund
Mr. Laird Landmann, TCW
Mr. Jack Lazzaro, TCW
Mr. Matt Toms, Voya Investment Management
Ms. Sandy Sinor, Voya Investment Management
Mr. Conor Sullivan, Voya Investment Management
Ms. Kelsi Hogg, Legislative Audit
Mr. Marc Watts, Arkansas Municipal League
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
Ms. Jessica Middleton-Kurylo, APERS General Counsel
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.

MINUTES:

Prior to the Board meeting, a copy of the Minutes from the August 17th meeting was mailed to each APERS Board member for review. Mayor Morris motioned to accept the Minutes as presented. He was seconded by Ms. Wright and the Minutes were approved.

ANNUAL ACTUARIAL VALUATION – Presented by Mr. David Hoffman & Mr. Mita Drazilov of Gabriel, Roeder, Smith & Associates

Mr. Drazilov reminded the Trustees that at the August board meeting they had reviewed the preliminary valuation and set a tentative Employer Rate (to begin on July 1, 2017) at 14.75%. At the October Investment Seminar, the Board adopted a rate for the District Judges. At today's meeting, Mr. Drazilov promised to go into the Valuation in more detail and lay out some of the challenges that the actuaries felt were facing the system in the future.

Mr. Hoffman spoke about the two General Financial Objectives of the system: to fully cover the cost of benefit commitments made to members and to maintain a level payment over a reasonable period to fully cover the unfunded liability. He continued and outlined changes that had been made to the system. No benefit changes had been made since the ones reflected in the 2009 valuation. The assumption was last changed for the June 30, 2016 valuation. In recognition of the 14.75% employer rate, adopted at the August 2016 Board meeting, the amortization period was updated to a 21-year period. Using the funding value, APERS is 80% funded and has a 76% funded ratio based upon market value.

He continued and showed the breakdown of the Employer Contribution Rate with 7.51% being the Employer Normal Cost and the Unfunded Actuarial Accrued Liabilities (UAAL) accounting for the additional 7.24% required, for a total rate of 14.75%.

Mr. Hoffman gave the comparative valuations for the last 15 years, and explained how despite the Employer Rate rising from 11.09% (2003) to a high of 14.88% (2012), the system was still considered stable and had greatly benefited from its prudent management over that time period. However, based upon low returns from the investments and expectations for this to continue in the near future, this rate will most likely be pushed higher in the upcoming years.

Before turning the floor over to Mr. Drazilov, Mr. Hoffman requested approval of the Annual Accounting Transfers. He explained that this was required by statute and was for accounting purposes only. These transfers do not affect the financial status of the fund. Ms. Wight motioned to approve the transfers and she was seconded by Mayor Morris. Motion passed.

Mr. Drazilov gave a brief history of the District Judges and how their small retirement system had been folded into APERS in 2007. Currently, their employers are divided into three categories: New Plan (includes all service after 2005), Old Plan (service prior to 2005) and the Still-Paying Old Plan (political sub-divisions who have not yet paid off for service prior to 2005). Each political sub-division in the Old Plan has a specific Employer Contribution rate that is charged to them until they are paid off. Once they have paid off their old liability, they pay just the New Plan pool rate (25.55%). Finally, he showed a complete list of the 53 District Judge employers and a breakdown of their membership, assets and liabilities. No action needed to be taken regarding the District Judges at this time.

Moving on, Mr. Drazilov asked the Board to review some graphs in the Callan quarterly report that focused on Projected Risk Analysis as of September 30, 2016. He explained that GRS' computer models showed a predicted investment gain of just 6.4% compounded over the next 10 years, given the current Asset Allocation. Presently, APERS has a 7.5% assumed rate of return, which the actuaries suggested is still too high. They proposed the Trustees should think about dropping it to 7.0% this year and to 6.5% in 2018. The actuaries acknowledged this would put a tremendous strain on the system, pushing the employer rate to new heights over the next few years. If new revenue streams could not be found, the only other choice was to re-examine the benefit provisions. Mr. Drazilov noted that he was not asking for a decision today, but the actuaries would probably be back in May to ask the Board to adopt a new (lower) investment return assumption to be used for the 2017 annual valuation.

Judge Hudson expressed concern over the actuarial report and asked sort of benefit changes might be proposed. Ms. Stone stated that raising the Employee Contribution Rate and/or compelling the Non-Contributory members to begin paying contributions had been considered in the past. She added that she had also previously discussed the idea of changing the 3% compounded COLA to CPI or 3%, whichever is less. Both of these changes would require legislative action, so the Trustees would need to begin action if they wanted any to be considered for the upcoming legislative session or they would have to wait two more years to make these changes.

Mayor Morris asked if it was normal for the Board to ask Staff to seek legislative sponsors for the contemplated changes since APERS would not meet again until mid-February. Ms. Stone admitted that was standard practice and the APERS Trustees might want to consider a special meeting in early January to decide what proposed changes they wished to submit to the legislators as all retirement bills had to be filed by January 27th. Mayor Morris opined that he felt that was the direction the Board should take.

Judge Hudson stated he felt the Board needed more facts before bringing it to any legislator or committee. He commented that APERS was an outstanding benefit offered to county employees for their public service and if design changes were needed to ensure its continuation that was how they should proceed and a study should be performed.

Mayor Morris agreed with Judge Hudson and motioned for Ms. Stone to monitor the situation closely, research options, get with legislators, provide the Trustees with advance copies of any bills, and if needed, call for a special board meeting in early January 2017. Ms. Stone stated that in the past, she would normally get with the GRS actuaries and go over plan design options and their cost/cost savings which she would review with the Board, so they could decide if they were interested in pursuing any of the options. She also explained to the Trustees that in the past, many states offered a compound COLA to their retirees, but presently they were few and far between. With no more discussion on the motion Mr. Williams restated it and Ms. Wright seconded. The motion passed

After a short discussion regarding the future of Defined Benefit plans versus Defined Contribution plans, Mr. Williams asked for a motion and a second to ratify the Employer Contribution amount of 14.75% that the Board had tentatively set at the August meeting. Mayor Morris made the motion and was seconded by Mr. Gaddy. Motion passed unanimously.

QUARTERLY REPORT FOR THE PERIOD ENDING SEPTEMBER 30, 2016 - Presented by Mr. Ryan Ball & Ms. Brienne Weymouth of Callan Associates, Inc.

Mr. Ball noted that during the first three months of the fiscal year a lot had happened; the Chicago Cubs finally won a World Series and the U.S election was just around the corner. It had been an over-all good quarter that began with a bounce-back from the sharp drop in markets since the BREXIT vote. U.S equities were up; International Equities performed well, but Emerging Markets did even better. It was a quiet quarter for Fixed Income with riskier assets returning the most dividends.

Actual Asset Allocation was close to Target Allocation with the slight overweight in Domestic Equities due to the good markets.

The Fund returned 3.94% for the quarter and 10.72% over the trailing 12-months, putting it in the top 11% of similar-sized funds.

Ms. Weymouth detailed several managers' performances.

- **Lombardia** – fell short of its benchmark this quarter, returning 6.10% compared to the 8.87% return of the Russell 2000 Value Index. Performance has lagged over the longer term as it ranks in the bottom decile of peers over the trailing one, three and five-year periods. Callan recently performed an on-site review and their returns have increased since the election. Callan will continue to keep a close eye on this manager.
- **Newton** – was the only Diversified Manager to turn in a negative return for the quarter. Callan noted that the Newton portfolio was very conservative and given the investment environment of the quarter, that type of return was considered normal.
- **INVESCO Global REITS** – outperformed its benchmark by 20 basis points and ranked in the top quartile of peers.

LUNCH

Fixed Income Core+ Manager Presentations

Mr. Ball gave a brief history of why Callan was suggesting the replacement of the MacKay Shields Core+ portfolio. Currently, that manager handles about \$400 million for APERS. Each of the managers came in and after introductions, detailed the history and business strategy of their

investment vehicle. They discussed management, investment practices and fees before taking questions and answers from the Board members.

- **DoubleLine** – Presented by Philip Barach (President), Ryan Hart (Senior Manager), and Barbara Ziegler (Relationship Manager)
- **TCW** – Presented by Laird Landmann (Managing Director) & Jack Lazzaro (Senior Vice President)
- **Voya** – Presented by Matt Toms (CIO Fixed Income), Sandy Sinor (SVP, Client Advisor) and Conor Sullivan (Consultant Relations)

After all three presentations were completed, Mr. Bret Cornwall, a Fixed Income specialist from Callan reviewed the individual managers. After a lengthy discussion regarding fees, co-mingled accounts and leadership, Mr. Gaddy motioned to hire DoubleLine subject on them agreeing to more competitive pricing on their fees (20 bp). Mayor Morris seconded and the motions passed.

SUMMARY OF RETIREES FOR SEPTEMBER, OCTOBER & NOVEMBER 2016 :

Ms. Stone noted that the retirement system was hitting the crest of the Baby Boomers and APERS was retiring a consistently high number of people each quarter.

MEDICAL REVIEW BOARD RECOMMENDATION:

The Medical Review Board met at 10:00 a.m. on Tuesday, November 8, 2016 in the APERS Library to discuss two (2) cases: Ms. Barbara Daniel and Ms. Angela Dawson.

- After review and discussion, the Medical Review Board found that Ms. Daniel was suffering from an illness or injury at the time of her termination in January 2014, which subsequently led to the disability determination.
- After review and discussion, the Medical Review Board found that Ms. Dawson was suffering from an illness or injury at the time of her termination in June 2015, which subsequently led to the disability determination.

With APERS Board approval, in accordance with ACA 24-4-511(e)(3) benefits for both members will be effective December 1, 2016. Mr. Gaddy motioned to accept the recommendations of the Medical Review. He was seconded by Ms. Wright and the motion carried.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING SEPTEMBER 30, 2016:

The Fund had a value of \$7.6 billion at the end of the first quarter. Over the last three months, APERS has paid out almost \$130 million in benefits to retirees and beneficiaries.

OTHER BUSINESS:

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

In October, the Judge in Woodruff County affirmed the Board's decision on that case. The three other pending cases (in Pulaski County) have not received a ruling from the Judge yet although she had previously stated she hoped to have a ruling in by the end of September. Mr. Wills commented that other than those cases, he was aware of no other litigation, pending or threatened, against the APERS Board

There was, however, a possibility of two possible hearings in February. In the first one, an appointed official was trying to get elected-official credit.

The second possible hearing was a rather emotional situation concerning a woman who was a member of both APERS and Teacher Retirement (ATRS). Ms. Gladys Bright had been a member of APERS for roughly nine years back in the 1980's before switching over to ATRS. She had applied for retirement on November 4, 2016, just missing the cut-off date for December, so her first check would have been on January 1, 2017. Ms. Bright selected the A-120 option and named her adult daughter (Ms. Harrison) as the beneficiary. Unfortunately, Ms. Bright died 4 days later, before she entered retirement status and thus was deemed a "Death in Service" under which only spouses, dependent parents, or children may collect. The daughter's A-120 benefit would have been roughly \$161 a month for 120 months or about \$16,000. She has been to six different

lawyers and Mr. Willis felt strongly that they would try to appeal it to the Board, once Ms. Stone had issued her official determination.

Mr. Gaddy asked for an update on the National Timber Partners (NTP) lawsuit. Mr. Willis joked that APERS had gotten lucky, as NTP had recently gotten into further legal trouble in Texas. While they were in Federal District Court there defending themselves, when it dawned upon them that since NTP had never paid APERS off, APERS had never executed an assignment to them and they had no right to do anything. NTP immediately came back with a figure, that the APERS team found acceptable and then executed a release to the NTP officials. Mr. Willis summed it up as APERS is now comfortably out of NTP and Staff feels very good about the recovery.

Securities Litigation Counsel Update – Presented by Mr. Jay Willis, APERS Deputy Director
Mr. Willis reminded the Board that two of APERS' security litigation firms, Keil-Goodson in Arkansas and Kessler-Topaz in Pennsylvania, had lawyers that were sanctioned by the District Judge in the Western District of Arkansas, based on the factual findings that those lawyers had put their personal fees ahead of the interest of the class. The lawyers have all appealed and while there had been no movement on the appeal.

Meanwhile, Kessler-Topaz had approached APERS with two cases that barely reached APERS action threshold. Mr. Willis subsequently learned that other law firms had turn down the cases for being too difficult for such small possible returns. APERS will probably decline those invitations and Mr. Will advised the Trustees that he did not wish the retirement system to earn the label "Professional Plaintiff" if you are involved in more than 5 cases in three years, which would make the system ineligible to be lead plaintiff. ATRS was recently denied Lead Plaintiff status in Pennsylvania due to them having been involved in 39 securities litigation lawsuits. Mr. Willis did not want to see APERS earn that designation.

New Pay Plan: Issues and Concerns – Presented by Ms. Gail Stone, APERS Executive Director

Ms. Stone discussed Governor Hutchinson's new pay plan with the board.

She expressed reservation about the caps put on some higher positions such as hers and the Deputy Director that would severely limit the Board's recruitment ability to attract highly qualified individuals. Rather than being a line item for Legislative approval, these positions would become "Executives" in the Federal model and the Board would be limited to offering roughly \$10,000 less than what Ms. Stone was currently making. She expressed concern that the pool of candidates for both hers and Jay's position would be extremely limited under the proposed pay plan. While it would not affect her or Mr. Willis, it did take away the bargaining power of the APERS board and gave it to the Governor.

Ms. Stone showed a salary survey conducted by NASRA and explained that she already made \$15,000 less than the median executive director in the U.S. and Mr. Willis made \$40,000 less than the median Deputy Director. She explained that this was such a specialized business, that by severely limiting the salary, it would make it impossible to attract qualified people. She asked why someone would give up being a Deputy Director position somewhere else to come be an Executive Director for less money. In this area of the county, only Oklahoma paid their retirement leaders a similar amount; other neighboring states paid their Directors about \$100,000 more and if you went as far as Alabama, their Director made over \$600,000. She was very concerned that this plan let the Governor come between the APERS Board and its Director and Deputy Director.

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

Ms. Stone apprised the Trustees that the COMPASS system was still on time, but due in part to the Governor's hiring freeze resulting in a temporary 20% reduction in permanent staff, it was no longer on budget. The Project Oversight Manager had to supply their own personnel to complete certain steps, because APERS was so short-staffed during critical steps in the project. An amendment has recently been submitted for an additional \$2.3 million.

Staff Travel Report

The report was noted without comments.

Approval of 2017 Board Meeting Dates

The normal meeting dates for the APERS Board next year would be:

- February 15, 2017
- May 17, 2017
- August 16, 2017
- November 15, 2017


The Capital Hotel has already been reserved for the 2017 Trustee Educational Seminar. That date is Tuesday, October 24, 2017.

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, February 15, 2017 at 9:00 a.m.

ADJOURNMENT:

There being no further business, the meeting was adjourned.


MR. ARTEE WILLIAMS, CHAIR


MS. GAIL STONE, EXECUTIVE DIRECTOR