

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
NOVEMBER 18, 2015**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, November 18, 2015 at 9:00 a.m., in the Conference Room, 124 West Capitol, Little Rock, Arkansas. Due to the absence of Mr. Williams, Vice-Chair Ouida Wright presided.

QUORUM PRESENT:

Ms. Wright recognized the presence of a quorum.

BOARD MEMBERS PRESENT:

Ms. Ouida Wright (State Employee Member), *Vice-Chair*, Conway, AR
Judge David Hudson, (Municipal Employee), Fort Smith, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Mayor David Morris, (City Employee), Searcy, AR
Hon. Andrea Lea, (Ex-Officio Member), State Auditor
Dr. John Shelnett, Department of Finance and Administration (*proxy*)
Mr. Jim Harris, Deputy State Treasurer (*proxy*)
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Mr. Artee Williams (State Employee Member), *Chair*, Maumelle, AR
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Hon. Larry Walther (Ex-Officio Member), Department of Finance and Administration Hon.
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
Mr. Mita Drazilov, Gabriel Roeder Smith
Mr. Scott Horrell, Horrell Capital Management
Mr. Ellis Sloan, Kernodle & Katon Asset Management
Mr. Jeff Kernodle, Kernodle & Katon Asset Management
Mr. Ben Katon, Kernodle & Katon Asset Management
Mr. Will Anderson, Kernodle & Katon Asset Management
Mr. Mike Knapp, Legislative Audit
Mr. Josh Curtis, Association of Arkansas Counties
Mr. Paul Young, Retiree
Mr. Mike Wickline, *Arkansas Democrat-Gazette*

STAFF PRESENT:

Mr. Carlos Borromeo, APERS Chief Investment Officer
Ms. Susan Bowers, APERS Associate Director of Investments
Mr. Jay Wills, APERS Chief Counsel
Mr. Craig Blackard, 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 meeting was mailed to each APERS Board member for review. On a motion made by Mayor Morris and seconded by Judge Hudson, the Minutes were approved as presented.

ANNUAL ACTUARIAL VALUATION FOR FISCAL YEAR 2015 – Presented by Mr. David Hoffman & Mr. Mita Drazilov of Gabriel, Roeder, Smith and Company

Mr. Hoffman presented the results of the most recent Valuation. He noted the results were unchanged from the August preliminary report and reminded the Trustees for the reasons behind the annual valuation was to determine the necessary Employer Contribution required in the upcoming fiscal year to keep the system financially sound. Mr. Hoffman noted that there had been no benefit changes to the system since 2009, and there were none considered in this Valuation. He noted the economic assumptions were updated in the June 30, 2015 valuation to a 7.50% investment return assumption and a 3.25% wage inflation assumption. The Board adopted these assumptions at the August 19, 2015 Board meeting. The amortization period was also updated for the June 30, 2015 valuation to a 25-year closed period. On a Funding Value of Assets basis, the System has a 79% funded ratio. On a market value of assets basis, the System has an 81% funded ratio.

Ms. Stone queried the actuaries over the updated wage inflation number of 3.25% stating she believed it was supposed to be 3.5%. Mr. Drazilov confirmed that 3.25% was the correct number and perhaps she was thinking of adopted 2.5% price assumption. Ms. Stone noted the August Minutes had the wrong amount listed as the adopted wage inflation. After double-checking, it was confirmed that the wage inflation assumption in the August Minutes should be changed to 3.25%. Mr. Gaddy motion for the Minutes to be corrected and was seconded by Mayor Morris. Motion passed.

Mr. Drazilov broke down the various parts that comprised Employer Contribution Rates, explaining how the Employer Normal Cost plus the UAAL (Unfunded Assumed Actuarial Liabilities) were used in the calculations. For Fiscal Year 2017, the Employer Contribution Rate computed out to be 14.50%. He continued, using a chart to show how over the past ten years, the fund had ranged from being 106% over-funded in 2001 to 69% under-funded in 2012. Currently, the system has a 79% funded ratio. Over that same time period, the Employer Contribution Rate has stayed within a 5% range, varying from 10% to 14.88%. Ms. Stone added that the adoption of more conservative assumptions over the last few years had pushed the funded ratio down further than it would have otherwise been. Mr. Drazilov agreed and volunteered that had those assumptions not been used, the funded ratio would be more like 81%.

Noting that there were only three sources of APERS funding (employer contributions, employee contributions and investment gains) Mr. Drazilov stated that, in the long run, he expected the employer rate to stabilize close to the 14.88% the system had back in the mid-2000's. He explained with the expected lower returns from investment gains would put an upward pressure on the employer rate in the future.

Discussing the volatility and risk, Mr. Drazilov told the Trustees that APERS Value of Assets to Payroll was 4. This was substantially less than the ratio in many other public retirement systems and a very good thing for APERS. He stated that in many Public Safety plans the ratio was more like 10 and as such, those systems were extremely volatile.

Wrapping up, Mr. Drazilov pointed out that there were two items the Board needed to take action on before he could finish. The first was the formally adopt the 14.5% Employer Contribution Rate and the second was to approve the Annual Transfers to the system. He pointed out a spreadsheet that listed all the recommended transfer amounts.

Mayor Morris motioned to approve the Annual Transfers and he was seconded by Mr. Gaddy. Motion passed.

Judge Hudson motioned for the Board to formally approve 14.50% as the Employer Contribution Rate, beginning July 1, 2016. With a second by Mr. Gaddy, the motion was approved.

QUARTERLY REPORT FOR THE PERIOD ENDING SEPTEMBER 30, 2015 - Presented by Mr. Rvan Ball of Callan Associates, Inc.

Mr. Ball gave a brief summary of the stock market during the first quarter of Fiscal Year 2016. He noted that it had been the first negative quarter for U.S. Equities in almost 3 years. A major sell-off in China dragged down Emerging Markets and oil was down 24% in that time period. On a positive note, the U.S. GDP was revised up to 3.9% and housing-starts improved. The Fed continued to hold interest rates down.

APERS' Asset Allocation continued to be close to the Target Allocation.

The total fund returned (1.46%) for the trailing 12-months, but over the last 3, 5 and 10-year time periods APERS was in the top quartile of other public funds. For the quarter, the fund returned (5.99%). Isolating for the manager effect, Mr. Ball pointed out how APERS managers had outperformed 95% of their peers going out as far as the past 10 years.

He reviewed selected manager's individual performance noting that Manning & Napier has been especially challenged over the last several quarters. Their significant allocation to China has been a major detractor to their performance over the past year and Callan is keeping a close eye on them. Mr. Ball stressed that Manning & Napier's style was currently out of favor, but they had not changed their investing policies since being hired by APERS.

TA Realty Reinvestment

Mr. Ball reminded the Board that back in August they had seen presentations from LaSalle and TA Realty. At that time they had chosen to reinvest with LaSalle but held off making a decision about TA Realty due to some investor exodus and personnel changes. Callan had monitored TA Realty since the August meeting and was now comfortable things had stabilized at the firm. Mr. Ball recommended that the Trustees motion to continue their investment TA in Fund 11.

Mayor Morris motioned to reinvest with TA Realty into their Fund 11 at the \$50 million level. Mr. Gaddy seconded the motion. After a short discussion on Callan's observations regarding TA's recent changes, the motion passed.

SSgA 130/30 Investment

This strategy had been put back in place in 2005, Mr. Ball explained. Recently, SSgA had notified APERS Staff that APERS was now the lone investor in the SSgA Index Plus Edge strategy. As of September 30, 2015, APERS had roughly \$75.9 million invested in this portfolio (representing 1.0% of APERS total assets). Callan recommended that APERS terminate this investment and invest the funds elsewhere.

Mr. Gaddy made a motion to termination the SSgA portfolio and he was seconded by Judge Hudson. Motion carried.

BREAK

Arkansas Index – Presented by Mr. Ellis Sloan of Kernodle & Katon Asset Mgmt.

Ms. Stone gave a brief history, noting that APERS had become interested in investing in the Arkansas Index about 10 years ago; at the time, Mr. Sloan with working with Lathrop Investments in Little Rock. A short time later, Mr. Sloan moved to Horrell Capital Management, which is where the contract currently resides and is promulgated through the ALC Review Committee and signed by Mr. Scott Horrell.

Shortly before the May 2015 Board meeting, Mr. Sloan changed companies. He is now working out of the offices of Kernodle & Katon in Searcy and is asking the Board to move the money back under his specific management. Ms. Stone explained that if the Board wished to withdraw the account from Horrell Capital Management, the contact would be required to go through the Offices of State Procurement for an RFP bid. The winner would be the management firm with the lowest fee. With that, Ms. Stone stepped aside and Mr. Sloan stepped up to the microphone.

Mr. Sloan thanked the Board for having faith in him for the past 9½ years and allowing him to service the Arkansas Index portfolio for APERS. He noted that with the help of Staff he had come up with the guidelines, formulas and policies for maintaining the portfolio. He stated that he appreciated the foresight of the Arkansas Legislature in creating Act 412 of 1985 that encouraged state agencies to invest in Arkansas. Mr. Sloan said that his move to the new firm had been carefully staged over the course of a year, in order not to interfere with any of the processes of maintaining the Arkansas Index for APERS. He felt the move to Kernodle & Katon allowed him to offer more resources and better service to his clients. Mr. Sloan urged the Board conduct a manager search for someone to best maintain the Arkansas Index for APERS.

Mr. Borromeo explained that currently the portfolio remained at Horrell Capital under Mr. Horrell's control. He had performed an onsite review when APERS was notified about Mr.

Sloan's departure, which coincided with Horrell Capital partnering with The Circumference Group. After reviewing the processes Mr. Borromeo said he was comfortable with Horrell's management of the portfolio. Mr. Ball added that since The Circumference had taken over the quarterly reporting, the information was much more "robust". He noted that this local manager also had Arkansas Teacher Retirement System as an institutional client.

When asked about Horrell's performance by one of the new Trustees, Mr. Ball stated its returns were "consistent with its mandate". Mr. Sloan added that the portfolio was currently benchmarked against the S&P 500, but he felt that the Russell 3000 Value would be a better index to measure its performance against.

Mr. Gaddy asked for more information on The Circumference Group and Mr. Borromeo explained that this local Private Equity manager was founded by a group of former Alltel employees. Most recently, they had been awarded a \$20 million mandate from ATRS. In partnering with Horrell, it was hoped they would provide back-office and analytical support.

Ms. Wright attempted to sum up the decision before the Board as the choice between leaving the fund with Horrell or moving the monies to Kernodle & Katon so Mr. Sloan could continue to oversee it. Ms. Stone corrected her, explaining that the Office of Procurement had gotten much more involved with the retirement fund's investment contracts. While the Trustees could select large, institutional investment firms due to Callan's intensive database on those firms, Callan didn't have a database on Arkansas firms. Since the fund in question is an "Index Fund" it would require an RFP (Request for Proposal) which State Procurement would insist upon performing. In the end, the mandate would be given to the lowest bidder. So the decision the Trustees had to make was did they want to leave the funds with Horrell or did they want to perform an RFP?

Mr. Sloan defended his position as manager of the fund, telling the board that in the beginning he just utilized the data provided by the Economic Development Board but after several years, he discovered that the information was very out-of-date and unreliable. From then on he took it upon himself to reach out and establish connections with these companies to get accurate information.

Mr. Horrell was allowed to come to the microphone and give his opinion. He stated that he signed a contract with APERS 9 years ago and accepted the fiduciary responsibility for the fund. In May, shortly after Mr. Sloan left, Horrell had to do the employer rebalancing. Mr. Horrell pointed out that he had hired The Circumference Group as a sub-advisor to leverage the expertise in their deep and powerful team. Their hiring improved the timeliness of the reports, something that had been a problem under Mr. Sloan. Since Mr. Sloan left, Horrell has produced two reports and gotten them to APERS in accordance with the guidelines. Horrell has also performed two quarterly rebalancings and two corporate-action rebalancings since Mr. Sloan's departure. All of these were done in a timely fashion and in accordance with the APERS' guidelines. Finally, Mr. Horrell noted that he felt that for the first time there was an open line of communication with APERS. Previously, he felt it had been a fractured line of communication.

Mr. Borromeo agreed that interactions with Horrell have indeed improved; reports have been turned in in a timely manner, the process has been smooth, communication lines have been extremely good and everything is fully transparent. Horrell Capital has been very proactive with APERS over the last 6 months and he saw no reason to recommend a change to the Board.

Ms. Lea questioned why, if Mr. Horrell was Mr. Sloan's boss, that the problems were not corrected sooner? Ms. Stone answered that as far as the Board of Trustees was concerned, no problem had elevated to their level. The problems have all been "transactional" in nature and Staff has dealt with them. Since the Arkansas Index is rules-based, any decision to change the rules resides with the Board. She felt it came down to who could provide a better process and pointed out if it went to Procurement it was very possible that neither Mr. Horrell, nor Mr. Sloan might be awarded the mandate if they were underbid by a third-party. This mandate has a current value of \$89.2 million and represented 1.22% of the entire fund. Ms. Stone also noted that the Trustees didn't need to make a decision immediately, but could choose to wait until February when the contract would come up for renewal.

After several minutes of discussion, Mr. Gaddy motioned to table this discussion until the February meeting. Judge Hudson seconded the motion. As a matter of transparency, Mayor

Morris stated that Mr. Sloan was from his hometown of Searcy, and currently he served as the Mayor of Searcy where Kernodle & Katon was located. Also he knew relatives of both Mr. Horrell and Mr. Sloan, but felt that he could be very objective in this matter and would cast a vote. Ms. Wright called for the vote and it passed 4:2 (Lea and Harris voting against.)

(Mr. Harris left the meeting at this time).

SUMMARY OF RETIREES FOR SEPTEMBER, OCTOBER & NOVEMBER 2015 :

Ms. Stone reported that nothing had changed and Staff was still experiencing the baby-boomer bulge, as more and more workers retired each quarter.

MEDICAL REVIEW BOARD RECOMMENDATION:

The Medical Review Board met at 10:00 a.m. on Tuesday, November 10, 2015 in the APERS Library to discuss the case of Ms. Elizabeth Weinstein.

- After review and discussion, the Medical Review Board found that Ms. Weinstein was suffering from an illness or injury at the time of her termination in May 2011, which subsequently led to the disability determination.

With APERS Board approval, in accordance with ACA 24-4-511(e)(3) benefits for Ms. Weinstein will be effective December 1, 2015. Ms. Lea motioned to accept the recommendation of the Medical Review. She was seconded by Mr. Gaddy. Motion passed.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING SEPTEMBER 30, 2015:

As of the end of September, APERS was down to \$7 billion, but since then Ms. Stone stated that the 6% loss had been reversed and the fund was now worth \$7.3 billion. APERS had paid out \$126.2 million in benefits since July.

OTHER BUSINESS:

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

Ms. Stone stated that APERS was still on-time and on-budget for going live with the new computer system (COMPASS) early in 2017. But the project is barely moving ahead because of the attrition in staff has not been replenished due to the hiring freeze imposed by the Governor. APERS' is currently down 20% in Staff, especially in accounting. Ms. Stone noted that just recently she'd been allowed to hire a new CFO who would start December 7th.

With data cleansing, development and project management of the system, the amount budgeted to bring COMPASS online is about \$18 million

Staff Travel Report

The Trustees reviewed the report submitted by Mr. Borromeo without a comment. Ms. Stone added that she'd just returned from San Antonio in her capacity as an officer of NASRA. While there, she and her colleagues discussed the funded status of the various public systems. While APERS is in great shape, they are by no means alone. Ms. Stone commented that there have been too many headlines about Illinois and New Jersey, Stockton and San Jose, but not enough about the many other Defined Benefit plans around the country that are in good shape.

(Mr. Harris returned to the meeting at this time.)

Approval of 2016 Meeting Dates

Normal meeting dates for 2016 would be:

- February 17, 2016
- May 18, 2016
- August 17, 2016
- November 16, 2016

No one expressed a problem with any of the dates.

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, February 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.

Mayor Morris complimented Staff on the “very enlightening” 2015 Educational Seminar. He gave extra kudos to Mr. Borromeo for procuring Kathleen Hays, from Bloomberg Radio, and Byron Wien, From Blackstone as guest speakers.

ADJOURNMENT:

There being no further business, the meeting was adjourned.


MR. ARTEE WILLIAMS, CHAIR


MS. GAIL STONE, EXECUTIVE DIRECTOR