

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
NOVEMBER 20, 2013**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, November 20, 2013 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
Judge Mike Jacobs (County Employee), Clarksville, AR
Ms. Ouida Wright (State Employee Member), Conway, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Mr. Wes Goodner, State Treasurer Deputy (*proxy*)
Ms. Janet Harris, Deputy State Auditor (*proxy*)
Dr. John Shelnett, Dept. of Finance and Administration (*proxy*)
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Mayor Steve Northcutt (City Employee), Malvern, AR
Hon. Richard Weiss (Ex-Officio Member), Dept. of Finance and Administration
Hon. Charles Robinson, (Ex-Officio Member), State Treasurer
Hon. Charlie Daniels (Ex-Officio Member), State Auditor

VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Mr. Kevin Dolsen, Callan Associates, Inc.
Mr. Mita Drazilov, Gabriel Roeder Smith & Company
Mr. David Hoffman, Gabriel Roeder Smith & Company
Mr. Mike Knapp, Bureau of Legislative Audit
Mr. Paul Young, Arkansas Municipal League
Mr. Danny James, Arkansas State Employee Association
Ms. Jessica Middleton-Kurylo, Bureau of Legislative Research
Mr. Gary Isom, Arkansas Real Estate Commission
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
Ms. Jennifer Taylor, APERS Retiree Services Manager
Mr. Craig Blackard, APERS Accounting Coordinator
Mr. Jay Wills, APERS Attorney Specialist
Mr. John Trelloggen, APERS Internal Auditor
Ms. Becky Walker, APERS Administrative Service 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.

MINUTES:

Prior to the Board meeting, copies of the Minutes from the meeting of October 22, 2013 were mailed to each APERS Board member for review. A motion made by Judge Jacobs, seconded by Mr. Gaddy and the Minutes were approved as presented.

ANNUAL ACTUARIAL VALUATION FOR FISCAL YEAR 2013 – Presented by Mr. Mita Drazilov and Mr. David Hoffman of Gabriel, Roeder, Smith and Company

Mr. Drazilov began the presentation which covered the State, Local and General Assembly portions of the plan, as District Judges had been covered at the Educational Seminar the prior month. He reminded the board members that the two main purposes of Annual Valuation are to determine the necessary Employer Contribution rate for the upcoming fiscal year and to determine the funded value of the system. He reviewed the General Financial Objective for APERS and explained the actuarial valuation process by which the level contribution rate is determined.

A review of the annuitants as of June 30, 2013 showed there were 30,533 retirees and beneficiaries (including DROP participants) on the books, involving \$426,198,681 in annual payouts. Their average annual benefit is about \$14,000. Mr. Drazilov also noted that there were 45,703 active members, whose average age was 44.9 years with annual pay of \$35,285.

Mr. Hoffman reviewed the development of the Funding Value of Assets. As of June 30, 2013 the Market Value of the fund was \$6.418 million, with \$843 million coming from investment gains over the past 12 months. He reminded the Trustees how the 4-year “smoothing” process kept the volatility to a minimum and encouraged level employer contributions. Mr. Hoffman detailed the various gains/losses through risk areas. For Fiscal Year 2013, the fund gained 4.4% or about \$370.2 million mainly due to greater-than-expected investment returns and smaller pay increases. All of these areas were combined in the calculation of the Employer Contribution Rate, which beginning July 1, 2014 was figured to be 14.76%. He noted that this was one basis point off from the rate presented at the August meeting.

Dr. Shelnutt questioned the logic of the 4% wage assumption used by the actuaries. Mr. Drazilov agreed that over the most recent period the average Arkansas state employees had not received a raise of that size, but this figure also encompassed a 3% price inflation rate. He also noted that this was viewed as a long-term assumption.

Mr. Hoffman explained that compared to previous years, the upward pressure on the Employer Contribution Rate had eased, initially allowing them to lower it to 13.98%. He pointed out that they could shorten the amortization period by 5 years (to a 25-year, closed plan) and still maintain a rate slightly lower than the current rate of 14.88%. Mr. Drazilov noted that this would also put the Funded Ratio at 74.3%, a significant increase from the 68.9% level a year ago.

Mr. Drazilov reminded the Trustees that they needed to approve the annual transfers to the Deferred Annuity Accounts and the Retirement Reserve Accounts from the Employer Accumulation Accounts. He explained this was strictly an accounting exercise, as required by statutes and did not affect the funding level.

Finally, he stated that based upon the results of the June 30, 2013 actuarial valuation, APERS continued to satisfy the general financial objective of level contribution financing. The funded ratio of APERS had been adversely affected by the market downturn in late 2008 and early 2009, but it has begun to rebound. On a funding value of assets basis, the System had a 74% funded ratio. On a market value of assets basis, the System had a 77% funded ratio. Based upon experience through June 30, 2013, the State and Local Government contribution rate (including General Assembly members) should be 14.76% of covered payroll for the fiscal year beginning July 1, 2014.

Judge Jacobs motioned to adopt the new Employer Contribution rate of 14.76%, as well as the recommended transfers and he was seconded by Ms. Wright. Motion passed unanimously.

QUARTERLY REPORT FOR THE PERIOD ENDING SEPTEMBER 30, 2013 - Presented by Mr. Ryan Ball and Mr. Kevin Dolsen of Callan Associates, Inc.

Mr. Dolsen gave an overview of the Active Markets, for both the U.S. and international. He pointed out that the broad markets had all had a good quarter. At the end of the quarter, the market value of the fund stood at an all-time high of just over \$7 billion, even after significant benefit payouts. Ms. Stone explained that there had been \$8 million in DROP payments pulled out of the fund in July. The Trustees celebrated the wonderful news with a round of applause.

Mr. Dolsen discussed the Asset Allocation, noting the overweight in Domestic Equities was due to market movement and would provide the monies for future benefit payouts as Staff worked to stay near the Target Allocation. The underweight in Real Assets was actually smaller than the 4% listed; LaSalle had recently called for additional funds to invest in Real Estate.

For the quarter, the fund was up 6.57% and Mr. Dolsen noted the annualized number over the last five years was up 8.98%. Over the last 21¼ years (the longest period Callan had data on the system) the fund had annualized just over 8.16%. He also pointed out that over the last year, active management added 1.61% - a large number compared to Callan's other typical clients. Every manager turned in a positive performance for the past quarter. Mr. Dolsen reviewed the returns by Asset Class, noting outstanding individual manager's performances. He summed up the fund's recent performance as very strong and remarked that through the last three-year period APERS had finished in the top 10% among its peers. He reminded the Board members that the reason Staff worked so hard on rebalancing and diversifying during bull markets was to hold onto the monies during the downturns. Mr. Drazilov added that if the last 30 years has taught investors anything, it is to have enough of a cushion to sustain the fund through downtimes.

Ms. Stone noted that initial calculations showed the fund was up 9.7% for the fiscal year-to-date.

Bailey Gifford Guidelines:

Ms. Stone explained that as per the vote at the previous meeting, Baillie Gifford was in the process of being funded. Staff had worked with this manager to create working guidelines for APERS' newest international mandate. Ms. Stone distributed the proposed guidelines to all the trustees for review, noting that they were the standard guidelines for all APERS' international mandates, except for the individual manager's objectives.

After a short discussion regarding their fees, Mr. Gaddy motioned to adopt the recommended guidelines for Baillie Gifford. Mr. Goodner seconded and the motion passed.

SUMMARY OF RETIREES FOR SEPTEMBER, OCTOBER & NOVEMBER 2013 :

Ms. Stone remarked that there were a steadily increasing number of retirees annually that usually peaked in June and December.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING JUNE 30, 2013:

It was noted that the system paid out over \$108.4 million during the first three months of Fiscal Year 2014 and yet the fund had still managed to reach an all-time high in assets.

OTHER BUSINESS:

Report on Customer Satisfaction Survey – Mr. John Treloggen, APERS Auditor

At the request of Trustee Wright, the Internal Auditor did a review of the surveys routinely sent out to a cross-section of the members who come to the APERS' office. Ms. Stone explained that the feedback from the surveys has been favorable. Employee counseling was rated between 4.82 and 4.92 (on a 0-5 scale) for the past eight years. Employer and employee seminars consistently received similar ratings and favorable comments since 2011.

Ms. Stone noted that projections indicate the number of retirees will increase by 55% to 40,000 by 2020. Opportunities for monitoring customer feedback will increase as technology is enhanced and with the employment of the new pension administration system (COMPASS) as it comes online.

Staff Travel Report

The report was noted with few comments.

Tentative Schedule for 2014 Meetings

The proposed dates for the 2014 quarterly Board meetings are:

- February 19, 2014
- May 21, 2014
- August 20, 2014
- November 19, 2014

The Trustee Educational Seminar has been scheduled for Tuesday, October 28, 2014.

Legal Update – Mr. Jay Wills, APERS Attorney Specialist

National Timber Partners repayment

Mr. Wills informed the Board that National Timber Partners (NTP) has asked for a 30-day extension on their repayment deadline, which APERS granted. Their response was due to be filed today (November 20, 2013), however the Attorney General's office had called five days ago and notified Mr. Wills that Ms. Manners (NTP's lawyer) had called with a settlement offer for APERS. She had asked for an additional 30 days before they had to file their response. Mr. Wills noted that it appeared they were having trouble retaining local counsel and agreed to the extension. In an effort to recoup the funds due to APERS, he agreed to waive pre-judgment interest if full amount paid by December 31, 2013. NTP now has until December 19th to file their Responsive Pleading and he was hopeful for a serious and realistic settlement offer from them. Mr. Wills stated that he had instructed Ms. Haralson at the AG's office to inform them that if this was just buying time, that any additional time after the second 30-day extension, would come at the price of \$10 million per day (the approximate amount NTP owes to APERS).

County Nursing Home Employees

The second issue Mr. Wills wanted to make the Board aware of was related to the recently resolved issue with the Montgomery County Nursing Home employees. He reminded the Trustees that, by statute, the APERS Board was given final authority on APERS membership status of both county and municipal employees. He felt that the statute was designed so that the Board could resolve disputes regarding employees of entities that were already APERS members. Mr. Wills opined that the plaintiff's firm was using the APERS Board as a hammer to drag in people from employers who have never been members of APERS and have them declared "county employees" thus saddling those counties with a crushing liability for past-due pension payments.

At this point in time, three individuals had been identified and Mr. Wills had sent materials to not just the effected nursing homes, but also the counties where those employers were located. He suggested the Board might consider legislation to make it clear that the APERS Board's job was to decide the membership status of existing APERS employers, not to drag unwilling employers into the retirement system. Should anything material come up before the next regular meeting, Mr. Wills promised to make the trustees aware.

Cycle C Update

In 2008, the IRS began requiring state-wide pension plans to apply for tax deferred status under Cycle C, rather than being automatically issued one each year. Mr. Wills had promptly filed the required documents and had never heard back from the IRS. January 31, 2014 is the beginning of the next Cycle C and Mr. Will planned to file again for all three systems. Earlier this week, he had been contacted by a Ms. Patty Eisenberg from the IRS who wanted to clear up three minor details. Assuming this goes smoothly, APERS/AJRS/ASPRS would be the first retirement systems in Arkansas to be issued a tax-deferred status by the IRS. Mr. Wills noted that he would immediately have to begin the process all over again, but was optimistic that the second time around might be resolved faster.

Security Litigators

Earlier in the year, Staff had put out an RFP for potential Securities Litigators and got 14 responses back – including APERS two current Securities Litigators. Mr. Wills distributed a spreadsheet that listed all the candidates and their strengths/weaknesses. While Staff felt confident about all the candidates' abilities nationwide practice, their recommendation was to continue to retain the firms of Cohen Milstein (Washington D.C.) and Nix, Patterson & Roach (Texarkana), and add the following three firms:

- Bernstein Litowitz Berger & Grossman – for the depth of their long time experience
- Kessler Topaz – for their presence in the Netherlands/Europe
- Spector Roseman – for their global exposure

Mr. Will noted that retaining additional firms would cost APERS nothing, as their fees were paid out of any recovered funds at the judge's directive.

Judge Jacobs motioned to retain the two current securities litigating firms and hire the three additional ones recommended by Staff. He was seconded by Dr. Shelnutt and the motion carried unanimously.

Trustee Education: Fiduciary Duty – Mr. Jay Wills, APERS Attorney Specialist

Ms. Stone noted that since attending the recent PEW/Arnold conference, she had become much more aware of the need for on-going trustee education to fulfill the Board's fiduciary duty. Towards that end, she had discussed the matter with Chairman Williams and agreed that this topic needed to be addressed.

Mr. Wills conducted a lecture on Fiduciary Duty as it applies to pension plan board members, beginning with the "Source of the Fiduciary Duties". He explained that these Statutory Duties apply to not only Board Members/Trustees, but also Staff (with respect to the Trust). A.C.A. 24-1-101 puts an overriding responsibility on every Board Member, as a fiduciary, to act only for the exclusive purpose of providing benefits, investment management and administrative expertise. Additionally, A.C.A. 24-2-602(b) emphasizes that "the investments and reinvestments shall only be made in accordance with the prudent investor rule set forth in §§ 24-2-610 — 24-2-619" to avoid any conflict of interest. Finally, Mr. Wills distributed a handout that detailed the section of code that laid out specific duties for each trustee.

The second source of Fiduciary Duty came from the APERS' own regulations. Regulation 501(also known as the Investment Policy) outlines the duty of the Board to develop policies to run the retirement system, but also reminds Trustees of their additional duties. Mr. Wills highlighted the affirmative duties mentioned in Section VIII:

- The Board of Trustees shall review the total investment program.
- The Board shall approve the investment policy and provide overall direction to the administrative staff in the execution of the investment policy.
- The Board of Trustees shall review and approve or disapprove investment recommendations not governed by Investment Policy prior to their execution.
- The Board shall also review and approve investment policy changes, deletions, or additions.
- The Board shall review and approve or disapprove any contracts of a financial nature...

There are further specific duties mentioned in Section IX and XI that Board members needed to discharge in order to comply with their fiduciary duty to the fund.

The third source of these fiduciary duties comes from ERISA (Cycle C). Mr. Wills pointed out that ethically, everything the Board does is for the exclusive benefit of APERS' members and retirees. Failing that will not only subject the individual or group to ethical claims, but it also endangers the fund to potential loss of its tax-deferred status, thus threatening the very existence of the retirement system.

Mr. Wills finally touched on several common-law cases of "willful and intentional violation of fiduciary duty" that the courts decided trumped any "sovereign immunity" claim.

While the Trustees ate lunch, Mr. Wills continued by discussing the three duties each board member was charged with: the duty of loyalty, duty of care, and duty of prudence. If a Trustee is to hold a place on the Board, their highest loyalty must be to the retirement system and its members/retirees. This loyalty to APERS' membership supersedes any loyalty to a subset of members that a trustee might be representing. The members discussed several scenarios about how such requests for preferential treatment might be deflected.

The Duty of Care requires that the plan be administered properly. Trustees cannot delegate that authority to a third party completely; while they may use designees or investment experts to ease their workload, the ultimate responsibility of running the system is on their shoulders. Promulgating investment policies and procedures is one of these duties largely discharged through Regulation 501. Mr. Wills observed that the Duty of Care requires the Board to periodically and regularly review APERS' investments, investment policies and staff. There was a discussion of dealing with breach of duty of a fellow Board member or a problem with an APERS staff member.

The third duty of a fiduciary is the "Duty of Prudence". Mr. Wills noted this tends to be an evolving standard. Generally speaking, it requires sound judgment but it imposes a duty on the Board members to become educated. In an effort to assist the Trustees to discharge this duty,

APERS holds the annual educational seminar. Ms. Stone observed that there seemed to be reluctance on the part of the Trustees to travel for fear of coming under scrutiny from the press, but she strongly encouraged them to attend legitimate venues that would enhance their understanding of new investments areas and how portfolios came together. Mr. Wills agreed that "travel on the public dime" criticism should not override the need to improve a person's understanding of pensions and investments to fulfill their fiduciary duties. Ms. Stone added that Callan offered their "Callan College" several times a year and was a good place to begin Trustee education. Chair Williams asked if Ms. Stone could put together a list of acceptable conferences and venues for the Board members to review and she agreed.

Mr. Wills reviewed how to discharge the three different duties with examples for each type. He distributed a reference sheet that outlined the Duty of Care in its various forms, the Prudent Investor Rule, and noted that Trustees were expected to utilize special skills or expertise they had to the advantage of the system's members. Failure to discharge one's fiduciary duty can result in removal from the Board by the Governor and to incur a personal liability that you cannot escape. There was a short discussion regarding the "activism" practiced by the CALPERS Board before Mr. Wills wrapped up his presentation. Ms. Stone noted that the Actuaries would be giving a similar educational discussion in the near future.

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, February 19, 2014 at 9:00 a.m.

ADJOURNMENT:

There being no further business, the meeting was adjourned.


MR. ARTEE WILLIAMS, CHAIR


MS. GAIL STONE, EXECUTIVE DIRECTOR