

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

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, February 18, 2015 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*, Maumelle, AR
Mr. Mike Jacobs (County Employee), Clarksville, AR
Ms. Ouida Wright (State Employee Member), Conway, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Hon. Dennis Milligan, (Ex-Officio Member), State Treasurer
Hon. Andrea Lea, (Ex-Officio Member), State Auditor
Dr. John Shelnett, Department 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
Hon. Larry Walthers (Ex-Officio Member), Department of Finance and Administration

VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Ms. Brianne Weymouth, Callan Associates, Inc.
Mr. Jim Harris, Deputy State Treasurer (*proxy*)
Mr. George Franks, Deputy State Auditor (*proxy*)
Ms. Jessica Middleton-Kurylo, Bureau of Legislative Research
Ms. Lindsey Bailey, Association of Arkansas Counties
Mr. Chris Villines, Association of Arkansas Counties
Mr. Marc Watts, Arkansas State Employees Association
Mr. Paul Young, Arkansas Municipal League
Mr. Mike Knapp, Bureau of Legislative Audit
Mr. Jody Carreiro, Osborne & Carreiro

STAFF PRESENT:

Ms. Michele Williams, APERS Deputy Director
Mr. Carlos Borromeo, APERS Chief Investment Officer
Ms. Susan Bowers, APERS Associate Director of Investments
Ms. Sheila Watts, APERS Chief Fiscal Officer
Mr. Jay Wills, APERS Attorney Specialist
Ms. Becky Walker, APERS Administrative Service Manager
Ms. Linda McGrath, APERS Administrative Specialist

RECOGNITION OF NEW BOARD MEMBERS:

Mr. Williams recognized that there were several new faces at the board table as asked everyone around the room to introduce themselves.

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 meetings of October 28 and November 19, 2014 were mailed to each APERS Board member for review. On a motion made by Mr. Jacobs and seconded by Ms. Wright, the Minutes were approved as presented.

RECOMMENDATIONS FOR BOARD POSITIONS:

Ms. Stone explained to the Board that there would be two vacancies on the APERS Board that needed filling. The first was the municipal position previous held by Mayor Northcutt, since he was not re-elected to his municipal position the Trustees needed to decide how to fill his term, which runs until March 9, 2016. She highlighted §24-4-104(c)(2) which states:

If any state employee trustee leaves the employ of the state or if any non-state employee trustee leaves the employ of the participating public employer, the board shall, by a majority of the membership of the board, fill the vacancy for the remainder of the unexpired term by appointment of the state employee member or a non-state employee member, as the case may be.

There was a motion by Mr. Jacobs to appoint, by acclamation, Mr. David Morris, the Mayor of Searcy and former county judge. Ms. Wright seconded the motion and after a short discussion, it was a unanimous vote to ask Mayor Morris to finish out Mayor Northcutt's term on the APERS board.

Mr. Jacobs' expired position, however, was in the hands of the Governor. Ms. Wright motioned for Ms. Stone to write a letter to Governor Hutchinson requesting him to reappoint Mike Jacobs to another six year term on the APERS board. Mr. Gaddy seconded and the motion passed.

QUARTERLY REPORT FOR THE PERIOD ENDING DECEMBER 31, 2014 - Presented by Mr. Ryan Ball and Ms. Brianne Weymouth of Callan Associates, Inc.

Mr. Ball explained the various sections that comprised the Callan Quarterly report and urged all members, especially the new ones, to let him know if they had any questions or suggestions and he would do his best to address them. He started the report by summarizing the investment climate during the last quarter of calendar year 2014 as a volatile ride, returning 1.72%. The energy sector was the worst performer during the quarter and dragged down returns for the year, as well. Emerging Markets were hurt by falling energy prices.

The Actual Asset Allocation was close to the Target Asset Allocation. There was a 6% overweight in Domestic Equities due to strong market movement. The Real Asset class was underweight by 4%. Investments in this category are Real Estate, REITs, Energy and Timber. Mr. Ball reminded the Board at the August meeting APERS had hired a Core Real Estate manager (Heitman) and committed \$265 million to this mandate. Heitman only called up the money only as they found suitable investment vehicles; this was the reason Real Assets were still underweight.

Mr. Gaddy expressed concerns that the fund had been chronically overweight Domestic Equities for over two years. Ms. Stone pointed out the funds for payouts to retirees and beneficiaries were mainly drawn from the Domestic Equities accounts in an effort to maintain the Target Allocation. However, that market had been so strong that even with these regular draw-downs it was still over-weight; a very good problem to have. In reviewing the individual managers' performances, it was noted that \$32.4 million of the \$35.8 million paid out to retirees over the quarter, had come from Domestic Equity managers.

Ms. Weymouth discussed the relative attribution effect and pointed out how active management of the portfolio added 0.12% for the quarter. Asset Allocation added 0.18%, while the Target Return contributed 1.42%.

There was a short discussion on how the falling price of oil could affect the market and ultimately the portfolio. Ms. Stone suggested that if there was sufficient concern, the Board could invite Jerry Castellini, the manager of their energy portfolio, to the May meeting to give some insights on the market. No action was taken on the suggestion.

Several other managers with notable performances were:

- **Artisan Partners:** This International Equity portfolio posted a 0.76% return for the quarter placing it in the 1st percentile among their peer group. For the year, Artisan was in the top 4%, handily outperforming their benchmark in all time periods since inception (4¾ years). Callan summed it up as a truly extraordinary performance and had nothing but praise for this manager.

- **Manning & Napier:** This International Equity portfolio posted a (4.17%) return for the quarter, placing it in the 76 percentile among its peers and underperformed its index by 0.60%. For the year, Manning & Napier was in the 92 percentile with an underperformance of 3.08%. Callan met with this manager during the last quarter regarding their poor returns. Mr. Ball noted that their underperformance is not inconsistent with their style; they invest in stocks early before the market focuses on them.
- **Horrell Capital:** For the quarter, this passively managed portfolio posted a 10.39% return placing it in the top 1% of its peers. For the trailing twelve months, the Horrell portfolio grew by 20.37 and was in the top 5%. Mr. Ball explained that this portfolio was focused on Arkansas-based business and was rebalanced once a year. It was benchmarked against the S&P 500, but had far fewer stocks from which to select.

Callan College

Ms. Weymouth announced that there would be three Callan College programs offered in various cities across the U.S. this year. This educational program is designed to teach new board members all about the investment process and how to be a fiduciary. Subjects covered range from the manager search process and asset allocations to how to read performance reports. Ms. Stone reminded the Trustees that tuition, travel, lodging and a food per-diem would be provided for any board member who wished to attend.

Renewal of Professional Service Contracts

Ms. Stone distributed a page with the proposed contract limits and explained the formula, which uses generous Capital Market assumptions to project asset growth, for calculating the projected fees for each manager. She asked the Trustees to reaffirm that they would retain those managers for the basis points noted beside each name.

Dr. Shelnett mentioned that when he's attended a recent Highway Retirement meeting, he'd noted that their CastleArk fees were substantially lower than those paid by APERS. Ms. Stone explained that when the Board voted to retain the "Fayetteville Shale Fund" the 125 basis points was weighted with the All Cap portfolio's 35 basis points for a total of 85 basis points. When the Global Energy portfolio was added, CastleArk agreed to a much reduced fee of 100 basis points. Nothing had changed since that initial hiring. Conversely, ASHERS (Highway Retirement) has a totally different size of assets and management structure.

Mr. Gaddy asked if it might not be prudent to ask why what CastleArk does for Highway Retirement is priced differently than what they do for APERS? After a short discussion, Mr. Gaddy motioned to discuss with CastleArk the idea of lowering the fees on the two specialty funds. Mr. Jacobs seconded. Ms. Wright questioned if putting off the renewal of the professional contracts until after a response from CastleArk would cause Ms. Stone any difficulty in dealing with Procurement. Ms. Stone agreed it would cause a hardship. Ms. Wright proposed amending the motion to approve the proposed contract rates and limits, with the provision that Staff approach Mr. Castellini about adjusting the rates for the CastleArk products. Mr. Gaddy agreed to the amended motion and Mr. Jacobs maintained his second. Motion passed.

SUMMARY OF RETIREES FOR DECEMBER 2014, JANUARY & FEBRUARY 2015 :

The number of retirees for the past fiscal year represented an all-time high for the agency. This number was expected to climb even higher and peak through 2017-2018 as the bulk of the "baby-boomers" reach retirement age.

MEDICAL REVIEW BOARD RECOMMENDATIONS:

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

- After review and discussion, the Medical Review Board found that Ms. Heye was suffering from an illness or injury at the time of her termination in November 2012, which subsequently led to the disability determination.

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

FINANCIAL STATEMENTS FOR THE QUARTER ENDING DECEMBER 31, 2014:

For the first six months of this fiscal year, APERS has paid out an excess of \$226 million to retirees and beneficiaries. Ms. Stone pointed out that this put the agency on track for another all-time high in payouts, all the while continuing to grow the investment portfolio.

OTHER BUSINESS:

Legislative Update

Traditionally, at the February meeting the Board will consider pending legislation that affects the APERS' benefit program, Ms. Stone explained. She distributed copies of the pertinent two bills to the Trustees.

- **HB 1209** – An Act to amend the credited service received by certain officials in an employment position covered by the Arkansas Public Employees' Retirement System; and for other purposes.

This bill would allow City Councils and Quorum Courts to vote, each year, for elected officials to receive 2-for-1 credit with APERS. Ms. Stone pointed out that this bill is flawed as it violates IRS tax law that specifies Governmental plans must have a definitely determinable benefit. Allowing the benefit structure to change year-to-year violates this code. Ms. Stone invited Mr. Chris Villines to speak for the Association of Arkansas Counties on this matter.

Mr. Villines agreed that in order to get and retain highly qualified people to certain county positions, offering 2-for-1 service credit was a big incentive. He felt that this issue had been addressed in a previous legislative session by allowing the counties the ability to offer this benefit for certain positions. Generally, the employer paid for part of the additional credit and the employee paid the rest.

There was a discussion concerning the differences between an "employee" and an "elected-official" and Ms. Lea requested to see the Attorney General's Opinions concerning this matter and the constitutional issues referenced before she would feel confident to vote on this issue. Ms. Stone commented that the next regular meeting of the Trustees would not be until after the legislative session had convened, at which time the Board's opinion would be moot. She reminded the board that as it was written, HB1209 violated IRS tax-qualified code and passage of this bill would immediately cause APERS to lose its tax-exempt status with the IRS.

Mr. Jacob's motioned for APERS not to support HB1209 and was seconded by Ms. Wright. Motioned carried 5:2 (Lea, Milligan).

- **HB 1215** – An Act to amend the law concerning Public Employee Retirement plans; to specify the reporting requirements of all taxpayer-funded retirement systems; to specify the reporting requirements of all Public Employee Retirement Systems; and for other purposes.

Ms. Stone explained that this bill would require that, in addition to the six statewide retirement systems (APERS, ATRS, AJRS, ASPRS, LOPFI and ASHERS), all local municipal plans that had nothing to do with the six statewide plans would have to use a 4% rate of return to value their unfunded liabilities. This would need to be detailed out in their valuations each year. Ms. Stone pointed out that this is a very expensive discount rate, is not supported by GASB, and doesn't add to the picture. She stated that the system's actuaries were currently doing an analysis of HB1215 additional calculations based on the 4% rate and guessed that it would lower APERS funded status from the current 85% to around 42%. Consequently, the Employer Rate would skyrocket in an attempt to cover this "loss".

In visiting with the Chairmen of the Joint Retirement Committee two weeks prior, Ms. Stone commented they were very concerned what this would do to the smaller municipal funds and wanted their input before making any decisions.

Ms. Wright motioned for the APERS Board to go on record as opposing HB1215. Dr. Shelnett seconded the motion and it carried unanimously.

- **SB 80** – An Act to require a state agency that is an employer of members of the Arkansas Public Employees' Retirement System to make contribution by electronic transfer and to report contributions electronically; and for other purposes. **(Act 91 of 2015)**

Act 91 compels all APERS' employers to begin making their monthly employee statement and remittances electronically beginning July 1, 2017. Ms. Stone noted that there was a provision written into the law that allowed employers to ask the board for a waiver if they cannot comply with that timeline.

- **SB 251** – An Act to reappropriate the balance of the Capital Improvement Appropriations for the Arkansas Public Employees Retirement System; and for other purposes. **(Act 128 of 2015)**
- **SB 291** – An Act to make an appropriation to the Arkansas Public Employees Retirement System for development and implementation of a new pension administration system; and for other purposes. **(Act 195 of 2015)**

These two bills represented APERS' appropriations to fund the new Pension Administration System (COMPASS)

- **HB 1166** – An Act to make an appropriation for the personal services and operating expenses for the Arkansas Public Employees Retirement System for the fiscal year ending June 30, 2016; and for other purposes.

The final bill is APERS' regular budget appropriation, which is still being reviewed by the Joint Budget Committee. The rest of the bills were Shell Bills that has been filed "just in case" and would probably not go any further unless something exceptional occurred.

In consideration of a Special Meeting Regarding Woodruff County Nursing Home

Mr. Wills briefly reviewed the events of the past meetings regarding APERS membership of county-run nursing homes for the new Trustees on the Board. Previously, the Board had participated in three hearings, and currently those cases are on appeal to the Circuit Court of Pulaski County. In each of those three cases, the Board decided the applicants were not entitled to membership simply because their compensations were not "paid for by county-appropriated funds" (which is the current definition of a "county employee" eligible for APERS).

The Board still needs to hear and make a determination on the final nursing home in question – Woodruff County Nursing Home before any Circuit Court decision can be rendered. For a variety of reasons, this determination had been pending since August 2014. Mr. Wills hoped that the Trustees could come up with an agreeable date before the May 2015 meeting in which to resolve this matter. He expected the hearing with Attorney Randy Hall to last no more than 3-5 hours. After a short discussion, it was decided Mr. Wills would pick three dates and submit them to the Trustees for their availability.

Set DROP Interest Rate for upcoming Fiscal Year

Ms. Stone reminded the Trustees that in accordance to Board regulation, they would review and set the DROP interest rate at each February meeting for the upcoming fiscal year. She noted that each Trustee had received a letter from a concerned APERS member asking for the rate to be raised; currently the rate is at 2.50%. Included in each board folder were the results of a study done by the actuaries that detailed how changing the rate would affect the system. Ms. Stone noted that raising the rate back to 6%, as requested by the member, would instantly raise the Employer Rate from 14.5% to 14.8% on behalf of just 1,679 members. This would also raise the unfunded liability of the system over \$50 million.

After a short analysis of the 5-year and 10-year Treasury rates (the closest comparable investment vehicle) Mr. Jacobs motioned to keep the DROP Interest Rate at 2.50%. Mr. Gaddy seconded and the motion carried.

Annual Approval for Board Travel Reimbursements

Ms. Stone explained that according to *ACA §25-16-902* during the first meeting of each calendar year, the Board will establish travel reimbursement rates for Trustees performing official Board duties that take them over 50 miles from home or for educational purposes during 2015. This rate is currently set at 42 cents per mile. Mr. Jacobs motioned to approve reimbursement for travel under the state's guidelines. Mr. Gaddy seconded the motion and it passed unanimously.

Staff Travel Report

The Trustees reviewed write-up from the investment conference written by Mr. Borromeo.

Annual Legislative Audit Report

Ms. Stone announced that APERS' annual Legislative Audit Report had been published. Most of the Trustees confirmed that they had received their copy already. She noted that the agency had no findings and complimented Staff on all their hard work complying with all the rules.

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, May 20, 2015 at 9:00 a.m. A Special Hearing will be scheduled for some time in April to hear from the Woodruff County Nursing Home litigants.

ADJOURNMENT:

There being no further business, the meeting was adjourned.


MR. ARTEE WILLIAMS, CHAIR


MS. GAIL STONE, EXECUTIVE DIRECTOR