

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES  
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM  
AUGUST 17, 2016**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, August 17, 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  
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR  
Hon. Andrea Lea, (Ex-Officio Member), State Auditor  
Hon. Dennis Milligan, (Ex-Officio Member), State Treasurer (*left early*)  
Dr. John Shelnett, (Ex-Officio Member), Department of Finance and Admin. (*proxy*)  
Ms. Gail H. Stone (Executive Director), APERS

**VISITORS PRESENT:**

Mr. Ryan Ball, Callan Associates, Inc.  
Ms. Brianne Weymouth, Callan Associates, Inc.  
Mr. David Hoffman, Gabriel Roeder, Smith & Company  
Mr. Mike Knapp, Legislative Audit  
Mr. Scott Horrell, Horrell Capital Management  
Mr. Jeremy Hutchinson, Attorney for Mr. Ellis Sloan  
Mr. Daniel Faulkner, Attorney General's Office  
Mr. Grant Wallace, Treasurer's Office  
Mr. Gary Underwood, Treasurer's Office  
Mr. Chris Villines, Association of Arkansas Counties  
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  
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.

**AFFIRM BOARD CHAIR AND VICE-CHAIR:**

Mr. Gaddy motioned to nominate Mr. Williams for another term as Chair and Mayor Morris as Vice-Chair. Ms. Wright seconded the motion. Motion carried. Ms. Lea moved to receive the nominees by acclamation and was seconded by Mr. Gaddy. Motion passed.

**MINUTES:**

Prior to the Board meeting, copies of the Minutes from the May 18<sup>th</sup> meeting and October Educational Seminar were mailed to each APERS Board member for review. Judge Hudson motioned to accept the Minutes as presented. He was seconded Mr. Gaddy and the Minutes were approved.

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

Mr. Ball gave a brief overview of the investment climate during the first quarter of APERS fiscal year 2017. He explained that from an economic perspective, it was basically remained unchanged from the several quarters, despite the brief upheaval caused by BREXIT.

At the end of the quarter, the Asset Allocation was largely in-line with the Target Allocation. The slight overage in Domestic Equity was due to market movement and had not impacted the portfolio. Compared to other similar-sized public funds, APERS holds more International Equity and less Fixed Income than a majority of their peers. This has been an advantage to the fund over the last five years allowing it to perform better than 80% of other public funds. APERS' portfolio returned 2.11% for the quarter, handily beating its benchmark. For Fiscal Year 2016, the fund was flat, growing by just 0.30% almost even with its benchmark.

Ms. Weymouth detailed several managers' performances.

**Lombardia** - was down 14 basis points and underperformed their benchmark; it was their worst quarter returns in history. Poor returns were mainly due to the BREXIT vote and the smaller banks Lombardia held in their portfolio who were sharply affected by the falling interest rates. Callan met with them in Chicago recently. They have not changed their strategy and still have considerable holdings in their small cap portfolio. This has been a challenging market for this type of strategy and Callan is not recommending any action at this time, but they will monitor them closely.

**Manning and Napier** – had strong returns and finished in the top quartile when measured against their benchmark. This manager has rebounded nicely since Callan visited them earlier in the year.

**Prudential** – was up 3.45% for the quarter and was the top performer in their asset class.

**Investment Manager Organizational Developments**

**Baillie Gifford International** – announced the promotion of Ms. Jenny Davies to the ACWI ex US Alpha Portfolio Construction Group. Davies will transition from the firm's Global Alpha team, where she serves as a senior analyst. Her promotion is effective September 5, 2016.

**Fixed Income Core+ Manager Search**

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. Callan provided a search book that contained details on six alternative managers: Baird Advisors, Dodge & Cox, DoubleLine, Taplin Canida & Habacht, TCW Group, and Voya Investments.

After detailing these managers, their strategies and explaining why each had been selected for APERS, the board had a brief discussion before Mayor Morris motioned to hear presentations at the November meeting from three of the managers: DoubleLine, TCW Group, and Voya. Dr. Shelnutt seconded and the motion passed with one objection from Ms. Lea who only wanted to hear from two of the managers.

**Presentation by Mr. Jeremy Hutchinson**

Mr. Hutchinson explained that he was there as attorney for Mr. Ellis Sloan, who currently was employed by Katon & Kernodle, an investment manager located in Searcy, AR. He argued that Mr. Sloan had created the "Arkansas Index Fund" in 2002 for the Arkansas Municipal League. His departure from Horrell Capital, where the fund had been managed since 2006, represented "material change in management" and obligated the board to perform a new manager search.

Mr. Sloan would agree to reduce his management fee, should the mandate follow him to Katon & Kernodle. Mr. Hutchinson suggested this might trigger the Fiduciary Duty of the board to stay with the lowest fees and would require an RFP be performed by Office of Procurement.

Mayor Morris questioned if this would actually be a RFQ, however Ms. Stone corrected him that since this is a passive index fund, it would be an RFP based on bid price only.

Mr. Milligan made a motion for Staff to start an RFP for a manager of the state's Arkansas Index. Mr. Gaddy asked if APERS had ever done an RFP and Ms. Stone said they had. She reminded the Trustees that when then APERS Chair, Don Zimmerman, broached the idea of adding an Arkansas Index to the APERS portfolio, Callan was unable to perform its normal manager search

due to the size and uniqueness of the product. Instead Callan merely “vetted” them to make sure they had to correct licenses and insurance, but went no further. Now that there is a competitor, there must be comparative consideration through the Office of State Procurement.

Ms. Stone outline the steps that would have to be taken and the projected timeline. Judge Hudson asked if this was an “earning question or a fairness and equity question” and expressed surprise that the matter was still being discussed when he considered the matter had been resolved at a previous meeting. Mr. Hutchinson opined that it could be considered a fiduciary duty, since the Mr. Sloan was now offering to manage the index as a reduced fee through Katon & Kernodle. At the very least, with the material change in management at Horrell, the board should get the parties to rebid the contract. Ms. Lea inquired about the differences between making the decision in-house versus sending it off to Procurement. Ms. Stone admitted she was not sure on this particular issue, but similar ones in the past had proven to be very involved.

Ms. Bevis asked Mr. Hutchinson to state exactly what outcome Mr. Sloan was looking for from the APERS Board. He responded that Mr. Sloan felt that his departure from Horrell constituted a significant management change in the company and wanted a chance to bid on the work that he’d been performing since 2002. If APERS issued an RFP, then he would have that opportunity. Mr. Hutchinson added that Mr. Sloan felt that APERS had been, and was still, significantly over-paying for unsophisticated management of a passive index. Mr. Sloan was willing to reduce the fee considerably to earn APERS’ business.

Mayor Morris offered a substitute motion that the Board delay taking any action today and let Staff research the legal interpretation of the process the Board needs to take regarding RFP/RFQ and which actually applied to this situation. After further discussion, Mr. Milligan withdrew his motion. Ms. Stone suggested that she could contact Mr. Armstrong of OSP and then present that information to the Trustees at the upcoming Educational Seminar. Judge Hudson expressed concern over the confusion regarding RFP/RFQ and asserted that he wanted to make sure the Board operated in a transparent, legal, ethical, honorable and transparent manner.

Mayor Morris withdrew his substitute motion and suggested instead that they direct Staff to research the issue and for Ms. Stone to present that information to the Board in at the October Seminar. Mr. Williams asked Ms. Stone to gather that information for the Trustees and she said she and Deputy Director Wills would comply. Dr. Shelnett asked if Staff could include in their report, a technical review of how the Arkansas Index is calculated, so that the Trustees could see it was being managed correctly.

With the issue concluded for the time, Mr. Williams thanks Mr. Hutchinson for his presentation and stated he hoped this matter would be resolved at the October meeting

*(Treasurer Milligan left the meeting at this point and Mr. Gary Underwood took his seat at the table.)*

**PRELIMINARY ANNUAL VALUATION REVIEW – Presented by Mr. David Hoffman, Gabriel, Roeder, Smith & Associates**

Mr. Hoffman complimented the Staff and their quick turnaround of the fiscal year information in order that the actuaries could present the preliminary valuation at the August meeting. He noted that most of their plans would not receive their valuation for a couple of months. The purpose of this meeting was to establish an employer rate for the upcoming (2018) fiscal year. This rate would be ratified at the November meeting when the complete annual valuation was finished. Ms. Stone explained that setting a tentative rate allowed Cities and Counties to set their budgets in a timely fashion.

The actuary reminded the Board that at this stage of the retirement plan, investment returns were the overwhelming driver of the health of the plan. As of June 30, 2016, APERS has roughly \$7.5 billion in assets and payroll is \$1.7 billion, so assets are four times payroll. Benefit payouts on that date were under \$500 million, meaning assets are about 15 times benefit payouts. Mr. Hoffman showed the development of the Funding value of Assets was calculated using a 4-year “smoothing” process. This method took much of the volatility out of the investment income and allowed the plan to maintain a stable contribution rate. Based on calculations, Mr. Hoffman stated to the Board that the employer rate for FY 2018 should be set at 14.27%, down slightly from the 14.50% currently charged.

Despite the lower rate suggested by the calculations, Mr. Hoffman strongly urged the Trustees to adopt a higher rate. He detailed several scenarios involving various likely market returns over the next 4 years and in every case, the employer rate rose significantly. In the worst case scenario, the contribution rate jumped from the current 14.5% to more than 19.5% by 2020. He proposed that for rate stability, the Board continue to charge 14.5% of salary in an effort to slow down possible rate increases.

Mr. Hoffman also noted that in the past, APERS had adopted a “closed 24 year” amortization period. Under normal conditions, that would drop to 23 years. He also advised the Board to temporarily hold the amortization period to 24 years.

Judge Hudson stated that several years prior, APERS had dropped the employer rate and his county celebrated the news, since it meant that two hundred thousand dollars were freed up in the budget. They decided to hire a second ambulance crew. The next year the Employer Rate went back up and then up again. The county had to raise taxes to cover the new ambulance crew. He cautioned against moving the rate down unless the Board was confident they could keep it down. He pushed for maximum stability in the rate.

Mr. Hoffman answered a few more questions and the Trustees discussed possible courses of action. Finally, Judge Hudson motioned to set the Employer Rate at 14.75% in an effort to head off significantly higher rates in the near future. He was seconded by Ms. Bevis. Motion passed.

**2016 AUDIT RESULTS & PROPOSED 2017 AUDIT PLAN – By Mr. John Owens, APERS Internal Auditor**

Mr. Owens noted that the audit has been somewhat revised, changing the agency description in several areas due to the restructuring of the organization chart. He detailed the 4 audits and 1 special project that were completed for 2016.

- Benefit Accounting – Billing of Act 808 Retirees
- Age and Service Benefit – Benefit Calculations with Reciprocal Service
- Service Purchase – Delinquent Service Purchases
- Overpayments/Collections – Retiree Insurance Receivables
- Special Project – COMPASS: Interest Calculations for Member Deposit Accounts

All of the audits achieved their objectives and there were no findings on these five audits. Mr. Owens explained that due to a vacancy in the Auditor’s office, the number of audits had been cut from nine to the aforementioned five audits.

He continued his presentation detailing the planned audits for Fiscal Year 2017.

**2017 Audit Area      2017 Audit**

Investments	<ul style="list-style-type: none"> <li>Review of investment calculations (Domestic Fixed Income)</li> <li>Review of investment calculations (Domestic Equities)</li> <li>Review of investment calculations (International Fixed Income)</li> <li>Review of investment calculations (International Equities)</li> <li>Review settlement of trades (Domestic Fixed Income)</li> <li>Review settlement of trades (Domestic Equities)</li> <li>Review settlement of trades (International Fixed Income)</li> <li>Review settlement of trades (International Equities)</li> </ul>
Special Project	<p>COMPASS – APERS New Pension Administration System- SFY 2015-SFY 2017</p> <ul style="list-style-type: none"> <li>▪ Review of internal controls and segregations of duties for system controls</li> <li>▪ Create a list of reports and report parameters used by Internal Audit</li> <li>▪ Other testing and reviewing as requested during software design</li> <li>▪ Projects concerns identified prior to/after the “GO LIVE” date in March 2017</li> <li>▪ Occasional meeting on design detail specific for APERS operations</li> </ul>

Judge Hudson praised Staff’s thorough testing and Ms. Lea complimented how well the new system was working.

**SUMMARY OF RETIREES FOR JUNE, JULY & AUGUST 2016 :**

Ms. Stone stated that APERS had retired 541 people on July 1, a surprisingly high number in a year with no benefit enhancements or legislatively-induced retirements.

**FINANCIAL STATEMENTS FOR THE QUARTER ENDING JUNE 30, 2016:**

The Fund had a value of \$7.37 billion at the end of the fiscal year. Over the last 12 months, APERS has paid out over \$480 million in benefits to retirees and beneficiaries. Ms. Stone distributed a map showing where those funds had gone in Arkansas, broken down by county. She pointed out that Calhoun County, the least populous county in Arkansas, had added 2 new retirees bringing the total payouts in that county to over \$750,000 annually.

**OTHER BUSINESS:**

**Regulation Change: Regulation 402- Repayment of Refunded Contributions**

Ms. Stone explained that she was requesting emergency adoption of this regulation change, since the agency already had people trying to repay their refunded contributions and Staff would like to change the methodology. Previously, APERS had been unable to break down the cost and interest on individual years and required the member purchase all their time. With the new computer system, it was simple to break down the cost of repayment for a single year of service. Regulation 402 currently reads:

**REGULATION 402- 1986 - PARTIAL PAYMENT AGREEMENT**

Repayment of refunded contributions by a member to re-establish forfeited service must be made in one lump sum if the total due, including interest, is less than \$500. If \$500 or more, the member may choose to repay to enter into an agreement with the Retirement System to make partial payments in an amount and by a method determined by the Executive Director, subject to the following conditions:

1. The service credit will not be restored to the member's retirement account until full payment is received by the System.
2. Full payment must be made before a member, or his survivor, makes application for monthly benefits.
3. From each payment received, the System will first credit interest due and the remainder will be applied to reduce the principal due.
4. The System may cancel the agreement and refund to a former member the amount paid under the partial payment agreement if the former member does not pay, in one lump sum, the total amount due within six months after termination of covered employment.
5. The System may cancel the agreement and refund, to the person eligible for the refund, all amounts paid under the agreement if a member dies before completing payments, with the following exception:
  - a. If completing the payment will qualify a survivor or dependent for a monthly death in service benefit or will increase the amount of such benefit, then the System will accept payment of the balance due in one lump sum if paid within six months after the death of the member. If not paid within six months, the System will refund the amounts previously paid.
6. A person not a member of the System, but who is a member of another retirement system and eligible for Reciprocal Agreement coverage (Act 488 of 1965, as amended), for the purpose of repurchasing service credit under this Regulation will be considered a member.

Staff had cleaned up the language and it now reflected the change to allow members to purchase one year at a time. Ms. Stone asked for the changes to be adopted under the emergency procedure clause.

**REGULATION 402 – 1986 – REPAYMENT OF REFUNDED CONTRIBUTIONS**

Repayment of refunded contributions by a member to re-establish forfeited service must be made in the Retirement System one-year increments, subject to the following conditions:

1. Service credit will be restored to the member's retirement account as each year's full payment is received by the System.
2. Full payment must be made before a member, or his survivor, makes application for monthly benefits. The interest applied to such purchases shall equal the actuarially assumed rate of return during the period of original service.
3. A person not a member of the System, but who is a member of another retirement system and eligible for Reciprocal Agreement coverage (Act 488 of 1965, as amended), will be considered a member for the purpose of repurchasing service credit under this Regulation.

After a short discussion, Ms. Lea motioned for adoption of the changes to Regulation 402. She was seconded by Judge Hudson and the motion passed.

**Acceptance of New Employer – Little River Rural Development Authority**

Mr. Wills explained that this agency of 6 regular and 2 part-time employees applied several months ago to APERS. As per Regulation 309, the Board has final approval of the application. Mr. Wills assured the Trustees that he had reviewed their documentation and he was satisfied that they were eligible to join and would not endanger APERS' tax-deferred status. With the Board's approval, they would join beginning in September.

Mayor Morris motioned to approve Little River Rural Development Authority's application and was seconded by Mr. Gaddy. Motion passed unanimously.

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

Mr. Wills noted that there were only two outstanding matters, both nursing home cases. Woodruff County is on administrative appeal to the Circuit Court down there and the three nursing homes are on appeal in Pulaski County. In both counties, oral arguments have been held before a Judge within the last month. APERS' lawyers from the A.G. Office report back that both cases went well, in fact Mr. Hall, the opposing attorney in both cases, was forced to concede many of the points he raised on appeal before the board. Mr. Wills anticipated a decision on the Pulaski County cases within the next month. As far as Woodruff County, the Judge there struck 87 paragraphs of his appeal, so it is a pure administrative appeal and the Judge has promised to rule in a timely fashion.

**Securities Litigation Counsel Update – Presented by Mr. Jav Wills, APERS Deputy Director**

Mr. Wills 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.

While APERS does have current litigation pending with Kessler-Topaz (SeaWorld), the specific attorney mention is not involved and has never handled a case for APERS. On the other hand, Keil-Goodson is not currently involved with any case for the retirement system, but both lawyers have in the past. Mr. Wills stated that the judge found specific instances of "bad faith" on both Keil and Goodson, in structuring the settlement transaction to benefit themselves at the expense of the class they claimed to be representing.

Keil-Goodson has appealed that finding and Mr. Wills opined it would probably be a year before a decision was made due to court backlog. He felt these cases bear watching. Mr. Wills was concerned that if the Board accepted any new business from Keil-Goodson while this matter was still ongoing, it could leave APERS open to being sued by a disaffected class member.

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

Ms. Stone noted that the Board had heard a lot about the new COMPASS system during the Internal Auditor's report. She added that she had just returned from her annual conference for State Retirement Plan Administrators where she was pleased to learn from colleagues that were going, or had just gone through the same process, that APERS was hitting all the points. She projected that COMPASS development was on-time and on-budget to go live on March 20, 2017. Focus groups were planned to assist employers getting set up with the new system.

**STAFF TRAVEL REPORT:**

The report was noted without comments.

**NEXT QUARTERLY BOARD MEETING:**

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, November 16, 2016 at 9:00 a.m. The Trustee Educational Seminar will be held October 25, 2016 at the Capital Hotel in Little Rock, AR.

**ADJOURNMENT:**

There being no further business, the meeting was adjourned.

  
MR. ARTEE WILLIAMS, CHAIR

  
MS. GAIL STONE, EXECUTIVE DIRECTOR