

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
AUGUST 19, 2015**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, August 19, 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
Ms. Ouida Wright (State Employee Member), *Vice-Chair*, Conway, AR
Judge David Hudson, (Municipal Employee), Fort Smith, AR (*arrived 10 minute late*)
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Mayor David Morris, (City Employee), Searcy, AR
Hon. Andrea Lea, (Ex-Officio Member), State Auditor (*left during GRS report*)
Hon. Larry Walther (Ex-Officio Member), Department of Finance and Administration
Mr. Jason Brady, State Treasurer's Office (*proxy*) (*left during GRS report*)
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

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. James Buckingham, TA Realty
Mr. James Raisides, TA Realty
Mr. Jim Hutchinson, LaSalle Realty
Mr. Joe Munoz, LaSalle Realty
Mr. Matthew Walley, LaSalle Realty
Mr. Joshua Pope, Legislative Audit
Mr. Chris Villines, Association of Arkansas Counties
Mr. Marc Watts, Arkansas State Employees Association
Mr. Paul Young, (*left during GRS report*)
Mr. Craig Schorr, A-B Global Investments
Mr. Mike Wickline, *Arkansas Democrat-Gazette*

STAFF PRESENT:

Mr. Carlos Borromeo, APERS Chief Investment Officer
Ms. Susan Bowers, APERS Associate Director of Investments
Ms. Jami Fisher, APERS Accounting Operations Manager
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 KAAZ. This letter of notification is pursuant to A.C.A. 25-19-101 (Act 93 of 1967) as amended-The Freedom of Information Act.

QUARTERLY REPORT FOR THE PERIOD ENDING JUNE 30, 2015 - Presented by Mr. Ryan Ball and Ms. Brianne Weymouth of Callan Associates, Inc.

Mr. Ball began his review of the quarter by giving the highlights of the broad market. He noted the final quarter of Fiscal Year 2015 got off to a decent start until the latter half of June when IMF

talks with Greece broke down and China experienced a huge sell-off in their equity markets. In the U.S., the GDP showed tepid growth, while labor participation hovers around historical lows. Interest rates moved up slightly, detracting from Domestic Fixed Income returns. U.S. equities were moderately positive for the tenth straight quarter in a row signifying good run for that sector.

The fund was overweight in Domestic Equity and underweight Real Assets. Mr. Ball stated that in early July, APERS' Core Real Estate manager, Heitman, had made a capital call for \$200 million, which had come out of Equity portfolios. Next quarter should show the Actual Asset Allocation to be much more in-line with the Target Allocation. The fund returned 2.45% for the trailing 12 months, but remained in the top decile of similarly-sized public funds over the 3- and 5-year horizon.

Ms. Weymouth reviewed the asset allocation and manager effects, and then individual manager results. The Callan representatives then discussed issues with individual managers:

- Manning & Napier has made some changes to their International portfolio as a result of their poor performance. They have reduced the number of decision makers on the team from seven to four. This will allow them to make decisions quicker. Manning & Napier has also reduced the number of names they will carry in the portfolio, making them less diversified.
- Lombardia's founder and majority owner died earlier this year. Currently, the ownership is being held in a trust by his widow. Callan does not see this as a viable, long term solution and would like to see it transferred to the current employees, if possible. Lombardia has already lost one large account and Callan is monitoring closely to see if this trend continues.
- AQR revealed to Callan that a former trader of theirs was being investigated by the SEC for trade violations. AQR immediately put him on leave and a week later, terminated him. It turned out that the "insider trading" had taken place at the investment firm the trader had worked for prior to AQR. Callan felt that this spoke highly of AQR to act so decisively in this matter.
- Westwood recently replaced their portfolio manager. Callan has done an on-site with the new manager and is comfortable with the company's choice, but will be keeping a close eye on the situation.
- Wellington self-reported to Callan that the SEC was conducting an inquiry within their firm, but Wellington has not being accused of any wrongdoing. Mr. Ball noted that the SEC was reviewing trades from the past ten years, or roughly 50 million transactions. He opined that they were merely utilizing new computerized tools and resources at their disposal in a proactive fashion. Ms. Weymouth noted that Wellington had undergone a similar investigation in 2012 and was given a clean report in 2014.

Mr. Ellis Sloan, previously of Horrell Capital, recently sent a letter to Ms. Stone announcing his desire to transfer the "Arkansas Index Fund" to a firm in Searcy, Kernoodle & Katon. However, Ms. Stone pointed out that the contract had been signed by Mr. Scott Horrell who argued that he would be keeping the assets at Horrell Capital since they were under his name. Mr. Sloan has now requested a hearing before the Board on this matter, possibly during the November meeting, to determine who actually controlled the portfolio. He felt that since he'd brought the funds to Horrell Capital in the first place back in 2007, he should be able to take them with him when he moved.

Ms. Stone commented that since this was a passive index fund, Staff was totally agnostic on where the fund resided. She noted that since Callan did not have an "Arkansas Manager base" to sift through, that the decision would be left to Procurement (OPM) where the RFP process meant the lowest fee would win, since it was an Index Fund. The portfolio is normally rebalanced once a year, typically the last week in June, and the last rebalancing was done by Horrell Capital. Ms. Stone also informed the Board that this contract would be up for renewal at the February 2016 meeting and the Trustees could easily wait until then to decide a plan of action.

After a short discussion on the different options, Mr. Gaddy motioned to invite Mr. Sloan to the November meeting to explain his case to the Board. He was seconded by Ms. Bevis and the motion carried unanimously.

MINUTES:

Prior to the Board meeting, a copy of the Minutes from the meeting of May 20, 2015 were mailed to each APERS Board member for review. On a motion made by Mayor Morris and seconded by Ms. Wright, the Minutes were approved as presented.

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

Mr. Hoffman introduced himself to the new Trustees and explained what functions the actuaries performed for the Board. He described the importance of Demographic Assumptions and Economic Assumptions and how they are used to calculate the “normal cost”. Once that is established, the cost of benefits and other expenses are added in and contributions are subtracted, leaving the Employer’s Normal Cost. After adding in the UAAL (Unfunded Actuarial Accrued Liabilities), one is left with the Total Employer Contribution. The preliminary Employer Contribution for Fiscal Year 2017 (beginning on July 1, 2016) was calculated to be 14.45%. He continued by detailing the how the actuaries smoothed the gains and losses in over a 4-year period and Fiscal Year 2015 saw an additional of \$71.3 million to be recognized.

There had been some changes in the Actuarial Standards of Practice and in the investment environment since last year, Mr. Hoffman told the Trustees and the previously adopted economic assumptions were no longer considered “reasonable”. He explained the current assumptions 7.75% (investment assumption) and 3.75% (wage inflation) were no longer acceptable to GASB and he suggested the Board adopt 7.5% expected return on investments and 3.25% for wage inflation. Currently, the system has a 79% funded ratio is 79%; on a market value basis, the funded ratio is 81%.

Mr. Hoffman outlined three future scenarios (spanning 2015-2018) based on the proposed economic assumptions. The most pessimistic scenario had the employer rate rising from current 14.45% up to 16.01% and the Funded Ratio dropping from 79% to 77%. The most optimistic scenario had APERS enjoying a 7.5% investment return every year of the scenario. In this instance, the Funded Ratio rose from 79% to 83% while the employer rate dropped to 13.51%. Several board members questioned why the employer rate was lowered under the more positive scenarios and Ms. Stone explained the powers of the APERS Board in setting the rate annually. Trustees discussed the idea of leaving the current employer rate (14.5%) in place, rather than dropping it to the actuarially-suggested rate of 14.45%.

After further discussion, Ms. Wright motioned to adopt the new assumptions suggested by the actuary and she was seconded by Ms. Bevis. The motion passed. Judge Hudson motioned to maintain the employer rate at 14.5% to stabilize the retirement system. Mayor Morris seconded and the motion carried unanimously.

Ms. Stone explained that traditionally the interest rate for purchase of service has been tied to the investment return assumption. The logic was that if the money had been in the system all along, it would have earned 7.75% during that time. Also, when the investment assumption was changed, the new interest rate for purchased service went into effect the following January 1st. If that was still acceptable to the Board, Ms. Stone said that Staff needed a motion to put it into effect. Ms. Wright motioned that as of January 1, 2016, the new interest rate for purchasing service would be set at 7.5% to match the new investment assumption rate. She was seconded by Mr. Gaddy and the motion passed.

Value-Added Real Estate Presentations

Mr. Ball explained for the new Trustees why APERS had a mandate to invest in Real Assets. Included in that category was “Value-Added Real Estate” which was currently underfunded. The two existing managers, TA Realty and LaSalle, would be coming in shortly to explain their current funds in hope that the APERS Trustees would choose to reinvest in their latest offerings.

Ms. Weymouth described how the “Value-Added Real Estate” strategy functioned. In these types of closed-end funds, once all the investment capital had been secured and the buildings improved, the manager would begin selling off these properties and returning the investors’ money until the entire portfolio was liquidated. Typically this cycle would take 10-12 years. She explained how

three to four years into the cycle, the investors would start to see their money returned and this was the ideal time to begin reinvesting it into the newest fund offering. Currently, APERS is invested in LaSalle's Fund #6 and TA Realty's Fund #11. Both managers would be asking the Trustees to reinvest in basically the same programs that they had initially invested in three years ago, but since many of the Trustees were new Callan felt it would be beneficial for the managers to explain their products.

TA Realty - Presented by Mr. James Buckingham & Mr. James Raisides

Mr. Buckingham quickly reviewed Fund #10's current holdings, performance and future expectations. He outlined TA Realty's history, organization, fund strategy and showed property examples. Finally, he discussed why APERS should invest in Fund #11 and noted that July 2016 was Fund#11's closing date.

LaSalle – Presented by Mr. Jim Hutchinson, Mr. Joe Munoz & Mr. Matthew Walley

Mr. Hutchinson began by thanking the Board for investing in Fund #6 and strongly encouraged them to reinvest the monies into Fund #7. His team outlined their corporate structure, fund life span and described the property types that they utilized. Finally, Mr. Walley discussed breaks in management fees and deadlines for discounts.

After the presentations, Mr. Ball touched on a few note-worthy items. First was the eventual retirement of Mr. Hutchinson from LaSalle in approximately five years. Mr. Ball noted that his departure would trigger Callan's "key-man provision", however at this time they were very comfortable with the remaining players and had no reservations about APERS investment into Fund #7. Mr. Ball also noted that TA Realty had earlier in 2015 been purchased a subsidiary of Mitsubishi called Rockefeller Investment Group. He felt it was a positive move as it expanded ownership among the top employees, however just a few days ago, Mass PRIM, the public plan in Massachusetts, announced that they were terminating their billion dollar mandate with TA Realty for a Core Real Estate investment. Callan suggested that perhaps APERS postpone any decision on TA Realty for three months to let the dust settle.

After several questions and comments from the Trustees, Mr. Gaddy made a motion to invest \$50 million in the LaSalle Fund #7 immediately and hold off on a decision on TA Realty until the November meeting. Mayor Morris seconded and the motion passed.

SUMMARY OF RETIREES FOR JUNE, JULY & AUGUST 2015 :

Ms. Stone pointed out that APERS had processed 425 members for a July 1 retirement; otherwise it was normally around 150 per month. She then distributed a county map of Arkansas to show how much money APERS pays out across the state and stated that roughly 94% of those benefits are spent locally. Using Calhoun County as an example (82 retirees and \$650,000), she emphasized what a powerful economic engine the retirement system is for Arkansas.

MEDICAL REVIEW BOARD RECOMMENDATIONS:

The Medical Review Board met at 10:00 a.m. on Tuesday, August 11, 2015 in the APERS Library to discuss the case of Ms. Valerie A. Walker.

- After review and discussion, the Medical Review Board recommended the denial of disability retirement for Ms. Valerie A. Walker at this time, pending further information.

Mr. Gaddy motioned to follow the advice of the Medical Review Board and was seconded by Mayor Morris. Motion passed.

2015 INTERNAL AUDIT RESULTS & PROPOSED 2016 AUDIT SCHEDULE -Presented by Mr. Craig Blackard, APERS internal Auditor

Mr. Blackard explained that the FY2015 Internal Audit Work Schedule consisted of thirteen (13) audits that were combined into five revised comprehensive audits.

List of Audits:

1. Review agency practices for records retention
2. Review the processes for the collection of overpayments
 - a. Review the collection process for deceased retiree annuity payments
 - b. Review the collection of erroneous annuity payments from deceased member beneficiaries

- c. Review the accounting of retiree overpayments
 - d. Review the collection process for overpayment of annuities
3. **Review employer contributions for compliance and accuracy**
 - a. Review employer contributions
 - b. Review employer compliance to contributions rates
 - c. Review employer contributions for AASIS employers
 4. **Review the process of employee service purchases and repayments**
 - a. Review the purchases of prior service
 - b. Review the purchase of military service
 - c. Review the partial purchase of service payments
 5. **Review the process for member history adjustments**
 - a. Review the process for member history adjustments for AASIS employers
 - b. Review the process for member history adjustments

Mr. Blackard noted that three (3) audits in the work schedule achieved audit objectives. However, two (2) audits, Review agency practices for records retention, and Review the processes for the collection of overpayments, failed to attain objectives and effectiveness of agency operations. He gave recommendations for improving these areas and cited actions that had already been taken.

Mr. Blackard detailed the nine (9) internal audits and one (1) special project he planned to complete during this upcoming fiscal year.

They were:

<u>Audit Area</u>	<u>Audit Objective</u>
Member Records	Review member records in MARSS
Service Purchases	Review of delinquent service purchases for new contributory plan
Computer Sys./Application	Review member status codes in MARSS
Age and Service Benefits	Review DROP balances in MARSS
Age and Service Benefits	Review of QDRO calculations
Age and Service Benefits	Review benefit calculations with reciprocal service
Age and Service Benefits	Review calculations of monthly annuities
Benefit Accounting	Review process for billing of act 808 retirees
Benefit Accounting	Review process for collection of retiree insurance receivable

Special Project: COMPASS – APERS New Pension Administration System FY 2015-2017

- Review of internal controls and segregations of duties for system controls
- Create a list of reports and report parameters used by Internal Audit
- Other testing and reviewing as requested

Mr. Blackard cautioned that there was the possibility that the Special Project could get so large and involved that he might be forced to drop so of the other planned audits to complete the audit on COMPASS.

Mr. Williams thanked Mr. Blackard for his hard work and Judge Hudson motioned to accept the proposed internal audit. He was seconded by Mayor Morris and the motion passed.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING JUNE 30, 2015:

Ms. Stone pointed out that the retirement system had paid out over \$450 million in benefits for Fiscal Year 2015. This averaged out to about \$30 million more than the previous year. On June 30, 2015 the fund was valued at \$7.54 billion.

OTHER BUSINESS:

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

Ms. Stone informed the Board that Staff was working full bore on the new COMPASS system; however APERS' CFO recently resigned to take a job in the private sector. Currently the position was frozen and it did not look like APERS would be able to hire a replacement in the near future. This vacancy was putting a severe bind on all General Ledger mapping that was needed for the new computer system. Mr. Walther indicated he would look into the matter.

Staff Travel Report

The Trustees reviewed write-ups by Mr. Wills and Mr. Davis without a comment.

Cycle C Update – Presented by Mr. Jay Wills, APERS Chief Counsel

In 2008, the IRS started a pilot project that required state level pension funds to obtain qualification letters to order to retain their tax-deferred status. Mr. Wills made submissions in 2008 on behalf of APERS, AJRS and ASPRS. He heard nothing back regarding the 5-year cycle, but resubmitted his answers in 2013. In June, Mr. Wills received a phone call from the IRS granting all three systems tax-qualified status through January 31, 2019 and they have discontinued the Cycle-C program. As far as Mr. Wills was aware, the three Arkansas retirement systems were the only state level programs that received tax-qualified status through the Cycle-C program.

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, November 18, 2015 at 9:00 a.m.

The Annual Trustee Educational Seminar will be held October 20, 2015 at the Capital Hotel in Little Rock, AR.

ADJOURNMENT:

There being no further business, the meeting was adjourned.

Ouida Wright, Vice Chair

MR. ARTEE WILLIAMS, CHAIR

Gail M. Stone

MS. GAIL STONE, EXECUTIVE DIRECTOR