

**MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
FEBRUARY 15, 2017**

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, February 15, 2017 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
Hon. Andrea Lea, (Ex-Officio Member), State Auditor (*via teleconference*)
Ms. Autumn Sanson, (Ex-Officio Member), State Treasurer (*proxy*)
Mr. Paul Louthian, (Ex-Officio Member), Department of Finance and Admin. (*proxy*)
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:

Ms. Carol Bevis, (Other, Non-State Employee), Little Rock, AR
Mr. Larry Walthers, (Ex-Officio Member), Department of Finance and Admin.

VISITORS PRESENT:

Mr. Ryan Ball, Callan Associates, Inc.
Ms. Brianne Weymouth, Callan Associates, Inc.
Mr. Jerry Castellini, CastleArk Management
Mr. Kevin Dolsen, CastleArk Management
Mr. Michael Knapp, Legislative Audit
Mr. Marc Watts, Arkansas Municipal League
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
Ms. Jessica Middleton-Kurylo, APERS General Counsel
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.

MINUTES:

Prior to the Board meeting, a copy of the Minutes from the November 16th meeting was mailed to each APERS Board member for review. Mr. Gaddy motioned to accept the Minutes as presented. He was by seconded Judge Hudson and the Minutes were approved. Judge Morris praised the level of detail in the Minutes and thanked Staff for all their diligent work in preparing them.

QUARTERLY REPORT FOR THE PERIOD ENDING DECEMBER 31, 2016 - Presented by Mr. Ryan Ball & Ms. Brianne Weymouth of Callan Associates, Inc.

Mr. Ball reviewed the previous quarter from an economic and market perspective. He noted that with the conclusion of the US election, the markets acted very favorably with rising interest rates and US Equities gaining. Non-U.S. markets were positive, however the strong dollar limited money coming back to the U.S. Developed Markets and Emerging Markets had a poor quarter.

Rising rates provided a nice headwind for Fixed Income, with the market showing favoritism to riskier investments.

Actual Asset Allocation was close to Target Allocation with the slight overweight in Domestic Equities due to the good markets.

The Fund returned 0.01% for the quarter and 7.29% over the trailing 12-months, putting it in the top two-thirds of similar-sized funds.

Judge Hudson inquired how Callan felt about the fund returning 7.29% against the actuarial target of 7.5%. Mr. Ball cautioned about making assumptions based upon any one year, and pointed out that over the last seven years, the fund has averaged 8.72%. Ms. Stone noted that over the past 25½ years, the system has averaged annual gains of 7.86% over several market cycles. She added that the fund had recently surpassed the \$8.0 billion mark, while at the same time paying out an all-time high in benefit payments. Ms. Weymouth insisted almost every other public plan Callan dealt with was working on lowering their actuarial assumed rate and APERS was not alone. Mr. Ball pointed out that the Actuaries were working on market assumptions looking forward.

Ms. Weymouth detailed several managers' outstanding returns and noted that Lombardia, who was already on Callan's Watch List, had continued to underperform their index and was in the bottom of their peer group over longer time periods. There had already been some sizable outflows from the portfolio, so Callan was recommending that this manager be terminated immediately before APERS was the last investor. Mr. Ball suggested the portfolio (\$164 million) be placed in an index fund until a new Small Cap Value manager was hired.

Judge Hudson motioned to follow Callan's suggestions and he was seconded by Mr. Gaddy. Motion passed.

Investment Guidelines – CastleArk and DoubleLine

Ms. Stone updated the Board on the status with DoubleLine, the Fixed Income Core+ manager APERS had hired in November. She noted that they would be funding them shortly with roughly \$419 million and Mr. Borromeo had worked diligently to get their fee down to the level approved by the trustees. Mr. Ball noted that the guidelines for DoubleLine which had been distributed to the board members was in standard language and acceptable to Staff and Callan.

Once Callan concluded with the DoubleLine discussion, Mr. Castellini and Mr. Dolsen stepped forward to give their presentation. Mr. Castellini reminded the trustees of CastleArk's almost 10-year focus on Arkansas Energy, centered around the Fayetteville Shale (natural gas) extraction. This program had proven so successful that APERS had later chosen to expand into a Global Energy strategy, also managed by CastleArk. Mr. Castellini posed the question if there might not be a better strategy for the APERS' energy investments than the one they currently used?

He pointed out that the Arkansas Energy portfolio was already a subset of the Global Energy portfolio, so keeping them separate added nothing to the mix. Mr. Castellini explained how OPEC had forced oil and gas producers to become extremely efficient in ways that were unheard of just 5 years ago. He noted that with new technology, the Permian Basin oil fields in west Texas had become the most efficient and competitive at extracting oil and gas in the world and encouraged board members to expand the portfolio to include these Texas oil fields. Mr. Castellini assured the Trustees that they would still get quarterly reports on the Arkansas exposure to gas and oil in the APERS' portfolio.

Mr. Dolsen discussed the inherent volatility in the oil and gas market and suggested that in addition to merging the two portfolios, CastleArk could offer some downside mitigation against the sharp volatility by opportunistically shorting exchange-traded funds against the portfolio. Mr. Castellini showed how the process had been working in a similar portfolio and urged the Trustees to allow him to incorporate it into the APERS' Global Energy mandate.

After a short discussion, Judge Hudson motioned approve the suggested guideline changes suggested by CastleArk which would allow them to merge the Arkansas Energy and the Global Energy portfolios, expand the Global Energy guidelines to include Shorting and to establish a fund for opportunistic shorting. Ms. Wright seconded the motion and it carried.

Ms. Stone noted that the motion did not include adopting the DoubleLine guidelines. Ms. Wright motioned to approve the guidelines for DoubleLine as submitted and was seconded by Judge Hudson. Motion passed.

Renewal of Profession Service Contracts

Ms. Stone reviewed the spreadsheet, noting that except for two contracts, the amounts were identical to when the managers were first hired. Those two exceptions were Baillie Gifford (whose fee has gone down due to AJRS hiring them to run the same mandate) and Pareto Partners Shields (whose fee has gone up with the divestiture of MacKay Shields portfolio). Most of the other manager's accounts were grown using a very-generous 15% Capital Market Assumption, then calculated the projected fees for each manager. She noted that the manager's fees (in basis points) remained unchanged for numerous years. After a short discussion, Mayor Morris motioned to approve the estimated manager fees and professional service contracts through Fiscal Year 2018. He was seconded by Mr. Gaddy and the motion carried.

SUMMARY OF RETIREES FOR DECEMBER 2016 , JANUARY & FEBRUARY 2017:

With the huge number of baby boomers retiring, APERS is currently paying out over a half-billion in benefits annually. Despite this, the fund is at an all-time high. Currently they system has about 1.2 active members to every retiree. APERS is projected to have a 1:1 active member/retiree ratio by the year 2025.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING DECEMBER 31, 2016:

The Fund had a value of \$7.55 billion at the end of the calendar year 2016. Over the last six months, APERS has paid out almost \$252.2 million in benefits to retirees and beneficiaries. Projecting the totals out another 6 months would have the system paying out roughly half a billion dollars in benefits for Fiscal Year 2017. Ms. Wright commented that when she was first appointed to the retirement board in 1987, the total fund assets were barely \$700 million and now APERS was close to paying that out annually in benefits.

OTHER BUSINESS:

Pending Legislation – Presented by Ms. Gail Stone, APERS Executive Director

Ms. Stone reminded the Trustees that this was the traditional meeting for the Board to take a stance on bills that affected the retirement system. She read through a list that Staff had prepared listing the bill number, sponsor, a short description and where each stood in committee.

- SB11 – Prohibits retirement systems for investing in certain restricted companies that are "restricted" by Iran or Sudan or who boycott Israel.

Requires "social investing" which the APERS board has traditionally been against; also Federal regulations already prohibit trade with Iran or Sudan. Bill will probably not go anywhere, but Staff recommends the board oppose this bill. *Board opposed.*

- SB184 – Mandates that APERS transfer DROP balances of reciprocal members to ATRS for the remaining 3 years of DROP participation.

This ATRS bill would require other state retirement systems with DROP shorter than 10 years (APERS, Highway, ASPRS, LOPFI) transfer the balance of a member's APERS DROP to ATRS if the member had reciprocal time in both systems. Staff calls this "an administrative nightmare" to implement, based on the many differences between the two retirement systems and recommends the board oppose this bill. Highway and LOPFI have also expressed opposition to this bill. *Board opposed.*

- SB202 – To again permit employment in a position covered by the State-supported retirement systems after participation in DROP.

This bill would undo a hard prohibition in place since 2011, in response to the outcry against "double dippers". Since then, unforeseen difficulties have come to light. Ms. Stone cited HB1187, showing how some agencies were trying to work around the language to be able to bring back people who were needed on staff. This bill would override HB1187 and make it unnecessary and Staff urges the Board to back this bill. *Board supports.*

- SB204 – To modify the application deadline for DROP from 2 months to one.

When this legislation was originally drafted, it took time to get all the proper forms filed and paperwork between APERS and the various employers coordinated. With computers, one month

(same as to file for retirement) is more than sufficient. Staff urges the trustees to support this legislation. *Board supports.*

- HB1187 – Allows the Forestry Commission employees who have participated in DROP to return to service if deemed “essential seasonal staff”.

Redundant if SB202 passes.

- HB1258 – Eliminates retirees from the board of trustees; lowers the years of service to be eligible for the board from 10 years to 5 years. Stipulates that the Governor fills the unexpired terms rather than the board.

This bill is currently out for amendment that would reinstate the possibility of having a retiree on the board, but at this point in time, Ms. Stone had no idea how it would read. The original bill removed all retirees from the retirement board, much to the concern and dismay of the thirty-five thousand APERS retirees. Also the current bill gives the Governor the right to appoint a person to fill any unexpired terms on the board, something the APERS board previously handled. The bill also lowered the APERS membership time from 10-years to 5-years to be eligible to be a board member. Ms. Stone stated that until the amendment was adopted and engrossed, she had no way of knowing how the final version might read. What she felt was very troubling was the statement under “do not codify section” that read “This act shall be immediately applicable to *a member* of the existing board”. Mr. Wills took that statement to mean any member of the existing board, while others in the legislature felt that “a member” referred to a specific person and was thus unconstitutional. The fact that this directive was inserted in the “do not codify section” was also disconcerting.

Currently, the composition of the APERS board is nine members consisting of: State Treasurer, State Auditor, Director of DF&A, three members who are state employees and three members who are non-state employees. Those later six members shall have at least ten years of continuous membership in APERS and shall be a member or a retired member of the system. Board member’s term is for 6 years. APERS has followed this board composition for at least the last thirty years.

Trustees expressed confusion and dismay over the proposed legislation. All agreed they “served at the pleasure of the Governor” but were confused as to why certain board members seemed to have been singled out. Ms. Wright stated that she was concerned over the change as it would remove those with the most experience, leaving only the newest trustees. She added that she had been on the APERS Board since March of 1987 and this would be her last meeting regardless if HB1258 passed or not. She emphasized that it took a while to understand all the complexities of the retirement system. Trustees had to put the needs of the members and beneficiaries first putting and put aside partisan agendas. Removing all the institutional knowledge by simultaneously removing all the retirees from the board was a bad idea and for that reason Ms. Wright was personally, strongly opposed HB1258, but would vote the way Staff recommended. *Board took no stance.*

- HB1282 – Regular appropriation bill.

This bill is already on the Governor’s desk for signature.

- HB1336 – Mandates forfeit of survivor benefits if the beneficiary murders or contributes to the death of member/retiree. (Slayer Statute)

Originally this bill, which covers all the state retirement systems, removed benefits from any member found guilty of any felony. Ms. Stone explained that representatives from all the state retirement systems had met with the bill’s sponsors and convinced him to amend it be only a “Slayer statute”. She had not seen the latest draft, so she was unsure of the current wording. Ms. Lea expressed deep concern that an “earned benefit” could be stripped from a member in such a fashion. Ms. Middleton-Kurylo assured the Board that she had spoken with the sponsor of this bill and felony forfeiture provision had been removed, leaving this as a simple Slayer Statute. *Board supports as Slayer Statute.*

- HB1368 – Concerning the purchase of service credit by public safety members.

This puts in plain language what is already being done, clarifying that all purchased military service is charged at the 1:1 rate, regardless of the member’s current service crediting.

Set DROP Interest Rate for Fiscal Year 2018

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 the current rate is at 2.50%. She distributed a graph showing the 10-year history of the interest rate associated with a 10-year Treasury yields. Currently, this investment offers just below 2.5% annual return. Ms. Stone opined that APERS' DROP Interest Rate should be somewhat in-line with this risk-free investment.

Mayor Morris motioned keep the DROP Interest Rate at 2.50%. Mr. Gaddy seconded and the motion was adopted.

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

Mr. Wills noted that the nursing home cases in Pulaski County are still awaiting a decision by Judge Gray.

The Jefferson County case of Mr. J. Y. Williams, who was seeking service credit, and Jefferson County has been pending before the Circuit Court down in Pine Bluff. The Judge had requested that any additional materials be submitted by March 15th. Mr. Wills expressed belief that there should be a decision on this case by the May board meeting.

He also noted that there would probably be two Board hearings that would need to be scheduled in the future, but he declined to set any dates until the Board composition had been decided. One of hearings would be regarding Mr. Jerry Hudlow, a City Treasurer who was claiming he was an elected official in order to collect 2:1 credit. Upon review, Mr. Wills determined he had never been elected, merely appointed to the position and reduced his years of service to 1:1. Mr. Hudlow was requesting a hearing before the board.

The second hearing involved the family of Ms. Bright. This member selected the A-120 option and named her adult daughter (Ms. Harrison) as the beneficiary. Unfortunately, Ms. Bright died 4 days later, before she entered retirement status, and thus was deemed a "Death in Service" under which only spouses, dependent parents, or dependent children may collect. Her daughter Ms. Harrison, was seeking to collect the A-120 benefit, which would have been roughly \$161 a month for 120 months or about \$16,000.

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 2016. This rate is currently set at 42 cents per mile. Mayor Morris motioned to approve reimbursement for travel under the state's guidelines. Ms. Wright seconded and the motion passed.

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

Ms. Stone stated the plans to "go live" with the new Pension Administration System in just one short month. This project had been in the works for a long time, with the initial hiring of a consultant back in 2012. The COMPASS system was still being rolled out on time, but due to the Governor's hiring freeze, it was no longer on budget. At one point in time, Staff was down over 20% and APERS was forced to pay for extra people from the consultant's staff to come in to help. This required the consultant's contract to be amended upwards by about \$1 million to cover that shortfall. Time wise, the system was set to roll out on March 20th.

Ms. Stone was especially proud of the Employer Reporting portal that would allow all APERS employers to report and remit electronically and stated it would vastly simplify their reporting needs. There would also be a soft rollout of the Member self-service portal, helping people get passwords and enroll so they can view their own accounts online, She finished by praising the APERS Staff for their hard work and dedication over the past two years, and for doing with it took to get this complex system up and running on time.

Board Goals

Judge Hudson spoke at length, asking for clarification on "Board Goals" and setting agendas. He felt that more clarification was needed on what the board should be focusing on and dealing with the employer contribution rate. He wished for more correlation between the Callan reports and the Actuary reports. Judge Hudson expressed concern over the replacement of several Board

members simultaneously, noting that he found it a very challenging board to be on and he admired the great track record that APERS had throughout its existence.

Mr. Gaddy thanked Mayor Morris and Judge Hudson for being such good and thoughtful additions to the Board. He cautioned that any substantial rise in either the Employer rate or the Employee Contribution rate would put pressure on the system to be turned from a Defined Benefit to a Defined Contribution plan, and this would be a tragedy.

Ms. Stone commented that she felt that many of the questions posed would be answered at the May board meeting. Both Callan and the Actuaries would be in attendance and available to answer questions. Also APERS Legal Staff (Mr. Wills and Ms. Middleton) had proposed a "Fiduciary Class" for the education of all the newer board members, defining their obligations and what they needed to focus on as Trustees of the APERS Trust Fund.

Mayor Morris echoed Judge Hudson's opinion that the retirement board was a very challenging board to serve upon. He noted that whenever he was tasked with a difficult decision, he asked himself these 4 questions before making any decisions:

Is it lawful?

Is it the right thing to do?

Is it ethical?

And finally, is it in the best interest of Searcy, or in this case, APERS?

Mayor Morris stated that the sole purpose of the board members was to "look after the retirees money." This included both current and future retirees.

NEXT QUARTERLY BOARD MEETING:

The next quarterly meeting of the APERS Board of Trustees is scheduled for Wednesday, May 17, 2017 at 9:00 a.m.

ADJOURNMENT:

There being no further business, the meeting was adjourned.


MAYOR DAVID MORRIS, CHAIR


MS. GAIL STONE, EXECUTIVE DIRECTOR