

MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING

Dr. Richard Abernathy, Chair

Monday, October 24, 2011

1:00 p.m.

1400 West Third Street
Little Rock, AR 72201

Board Members Present

Dr. Richard Abernathy, Chair
Beverly Leming, Vice Chair
David Cauldwell
Hazel Coleman
Dr. Tom Kimbrell
Danny Knight
Bobby Lester
Susannah Marshall, designee for Candace Franks
Donna Morey
Robin Nichols
Janelle Riddle
Honorable Martha Shoffner
Jeff Stubblefield

Board Members Absent

Lloyd Black
Honorable Charlie Daniels

Consultants Present

Michael Bacine, Franklin Park
Heather Christopher, Hewitt EnnisKnupp
Judy Kermans, GRS
Brian Murphy, GRS
Laurel Nicholson, Hewitt EnnisKnupp

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

Staff Present

George Hopkins, Executive Director
Gail Bolden, Deputy Director
Chris Ausbrooks, Senior Software Support
Bob Berry, Chief Fiscal Officer
Kay Daniels, Director's Assistant
Dena Dixon, Risk Mgmt/Internal Audit
Reed Edwards, Litigation Attorney
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Tammy Porter, Paralegal
Michael Ray, Dir. Member Services
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Internal Audit/Risk Mgmt

Guests Present

Chris Caldwell, Div. of Legislative Audit
Alan Fortney, Arkansas State Board of Public Accounting
Sarah Ganahl, Bureau of Leg. Research
Erika Gee, Attorney General's Office
Steve Singleton, ARTA

- I. **Call to Order/Roll Call.** Chair, Dr. Richard Abernathy, called the Board of Trustees meeting to order at 1:00 p.m. Roll call was taken. Lloyd Black and Honorable Charlie Daniels were absent.

- II. **Motion to Excuse Absences.**

Mr. Knight *moved to excuse* Lloyd Black and Honorable Charlie Daniels from the October 24, 2011, Board of Trustees meeting. Mr. Lester *seconded the motion*, and the Board *unanimously approved the motion*.

III. Adoption of Agenda.

Ms. Nichols *moved for adoption* of the Agenda. Ms. Morey *seconded the motion* the Board *unanimously approved the motion*.

IV. Executive Summary. The Executive Summary was provided for reference with no questions or expansions on the written summary.

V. Approval of Minutes.

A. Minutes of July 19, 2011.

Mr. Lester *moved for approval* of the Minutes of the Board of Trustees meeting of July 19, 2011. Ms. Nichols *seconded the motion*, and the Board *unanimously approved the motion*.

B. Minutes of August 8, 2011.

Mr. Lester *moved for approval* of the Minutes of the Board of Trustees meeting of August 8, 2011. Ms. Riddle *seconded the motion*, and the Board *unanimously approved the motion*.

VI. Actuary Update – Gabriel, Roeder, Smith & Company.

A. Actuarial Assumptions. Ms. Kermans and Mr. Murphy presented actuarial assumptions of the 2005-2010 experience study. GRS met with the Board at the July 19, 2011, meeting where they reviewed the full experience study for the five year period ending June 30, 2010. Recommendations were made based on the demographic assumptions of the study. Economic assumptions, plus two alternates, were also presented at that time. GRS has added two additional alternates to aid the Board in their decision making process.

Economic assumptions include long-term rates of investment return, wage growth, and price inflation. Unlike demographic assumptions, economic assumptions cannot be developed solely from historical patterns, so expectations of the future must be considered as well.

Ms. Kermans and Mr. Murphy prepared a wage inflation assumption model of 4%, 3.75%, 3.5%, 3.25% and 3%. The lower the wage inflation

assumption, the lower the liabilities that ATRS will reflect for salaries. The ATRS Board should adopt a wage inflation assumption component to state what ATRS foresees wage inflation will be looking forward. ATRS staff is convinced that any number between 3% and 3.75% is likely higher than what ATRS will experience in the next several years and would be a reasonable assumption. At the same time, if inflation reenters into the economy, the wage inflation assumption should not be too low. However, 4% appears to be unrealistic as a long term expectation of wage inflation for ATRS at this time. The Board discussed the assumptions at length.

Ms. Leming *moved to approve the recommendation of Hewitt EnnisKnupp maintain the goal of an 8% rate of investment return. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.*

Ms. Coleman *moved to approve economic assumption Alternate 3, which included an 8% return on investments and a 3.25% wage inflation rate. Ms. Leming seconded the motion, and the Board unanimously approved the motion.*

- VII. **Independent Actuarial Review to Comply with Rule 3-4.** Mr. Hopkins explained the need for an independent actuarial review to comply with ATRS Policy 3-4. This is a rule developed by ATRS several years ago. However, Gabriel, Roeder, Smith & Company (GRS) has some level of review every two years since the Public Retirement Committee has an actuary that also reviews the actuarial impact of legislation. That "outside review" is compared to the review conducted by GRS. The study of the accuracy of the ATRS actuaries cost ATRS approximately \$50,000 per review. ATRS Policy 3-4 states that this review should be done every five years. ATRS did check with the Arkansas Public Employees Retirement System and was told that APERS does not conduct this type of review. ATRS staff requests Board authorization to begin the RFQ process.

Ms. Coleman *moved to waive the independent actuarial review process for five years. Mr. Knight seconded the motion.*

There was discussion at length about whether the Board had the authority to waive the independent actuarial review process.

Ms. Coleman *withdrew the motion.*

ATRS staff will conduct research on the matter and forward this item to the December 2011 Board of Trustees agenda.

- VIII. **2012 Board of Trustees Election Schedule.** Mr. Hopkins explained the 2012 Board of Trustees election schedule. There are two positions up for election in 2012: Position #5, Administrator Trustee, and Position #11, Retirant Trustee. The election schedule was given to the Board for review.
- IX. **Report of Member Interest Waived under A.C.A. Sec. 24-4-205.** Mr. Hopkins reported on member interested waived since February 2011.
- X. **Report of Employer Interest and Penalties Waived under A.C.A. 24-7-411.** Mr. Hopkins reported on employer interest and penalties waived since February 2011.
- XI. **Investment Committee Report.** Ms. Leming gave a report on the Investment Committee meeting.

A. Arkansas Holding Update.

1. **Victory Building Update.** Final work is underway on a fitness center. The fitness center filled a physical space in the building that was previously difficult to fill. This brings the occupancy of the Victory Building to approximately 98%.
2. **Woodland Heights.** ATRS staff has concentrated a lot of effort in the last few months, along with RPM, to enhance the appearance and amenities at Woodland Heights. Many new residents must sell their homes to move to an independent living center. However, there are residents who have had to move out because they can no longer live on their own and must move to assisted living centers. The occupancy level continues to improve, though, with the current leased/pre-lease occupancy rate of about 68%.
3. **South Center in Hot Springs.** The Ross Dress for Less construction is well underway. The other tenants at South Center appreciate the changes to the appearance of the shopping center by the removal of the old auto and outdoor center that was on the side of the center facing the Hot Springs Mall. It appears all is on track for the construction to be completed by Spring 2012.
4. **Arkansas Farmland Update.** The first purchase from the farmland allocation made to ATRS was for a farm of approximately 2800 acres in Cross County, Arkansas. Halderman, ATRS' farmland manager, is in the process of reviewing other investment prospects.

B. General Investment Consultant Update – Hewitt EnnisKnupp.

1. **Portfolio Performance Update for the Quarter Ended June 30, 2011, plus Market Update.** Returns were slightly positive at 0.5% but performed below the benchmark of 1.2%, with negative performances in all asset classes. U.S. equity had a negative performance for the quarter of -1.2%, performing under the benchmark of 0%, but performed in line with its year to date benchmark of 6.4%. Global equity also had a negative performance for the quarter of -0.7%, performing under the benchmark of 0.2%. Fixed income had a positive performance for the quarter of 1.4%, performing under the benchmark of 2.2%, but is at 3.2% year to date, outperforming its year to date benchmark of 2.9%
2. **Authorization to Engage Transition Managers from an Approved Pool Whenever Needed (Resolution No. 2011-28).** ATRS occasionally has a fund that will unwind or is terminated by the Board. Transition managers are a specialized group and often focus on particular types of securities. In addition, a transition manager may be overloaded with transitions at a particular time that ATRS needs a transition manager. ATRS staff and Hewitt EnnisKnupp recommend that the Board of Trustees authorize ATRS staff to keep a pool of transition managers available in order that ATRS can always choose the best transition manager based upon work load and expertise of the manager in the particular transition. Hewitt EnnisKnupp has provided a list of seven approved transition managers, based upon current availability and expertise of the particular transition manager in the event the need arises for an ATRS transition. Approval of State Street was on hold due to recent concerns that have developed over an investigation of inappropriate transition fees. The Investment Committee recommended approving the pool of transition managers, minus State Street, for transition events.

Ms. Leming *moved to adopt* Resolution 2011-28, authorizing an ATRS Staff and Hewitt EnnisKnupp approved pool of transition managers to be used when a fund transition is needed. Ms. Nichols *seconded the motion*, and the Board *unanimously adopted the resolution*.

C. Real Estate Investment Consultant Update – Hewitt EnnisKnupp.

1. **Portfolio Performance Update for the Quarter ended June 30, 2011.** Real estate performance for the quarter was 1.8%, which performed under the NCREIF Property Index (NPI) of 3.9%. Net IRR improved by 10 basis points since the first quarter of 2011. The open end funds outperformed, while closed end funds performed in line with the benchmark. The second quarter was tough, largely attributed to a

one-time write down in value of Woodland Heights, but the portfolio did outperform the benchmark on the trailing one-year.

ATRS committed an additional \$50 million to Prudential PRISA during the first quarter of 2011. Significant capital calls from Fidelity and Rothschild accounted for \$70 million in contributions during the quarter. The pace of capital calls is expected to increase as transaction volume continues to increase in 2011. Two commitments remain for 2011: one currently recommended opportunistic commitment of \$50 million and two value-added commitments totaling \$70 million.

2. **Recommendation to Approve Blackstone Real Estate Partners Fund VII, L.P. (Resolution No. 2011-29).** Blackstone has formed the Blackstone Real Estate Partners Fund VII to focus on acquiring attractive opportunistic real estate investments, with a target fund raise of \$10 billion. The fund will target a 15% plus net IRR to investors and pursue a diversified portfolio of real estate related investments primarily in the United States, with some exposure to Europe and Asia.

Hewitt EnnisKnupp performed thorough due diligence on this fund, and although it offers a compelling investment opportunity, there are some concerns that need to be addressed. Blackstone's fees are relatively expensive, with the inclusion of an acquisition fee of 0.3% of the fund's share of the gross purchase price of assets. Despite the relatively expensive fee structure, Blackstone has historically been able to provide top quartile net returns to investors. The Investment Committee recommended a commitment of up to \$50 million, subject to satisfactory terms.

Ms. Leming moved to adopt Resolution 2011-29, approving a commitment of up to \$50 million Blackstone Real Estate Partners Fund VII, L.P., subject to satisfactory terms. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

D. Private Equity Investment Consultant Update – Franklin Park.

1. **Private Equity Portfolio Review for the Quarter ended June 30, 2011.** The net IRR for the aggregate portfolio since inception was 8.7%, with committed capital at approximately \$2.5 billion. The percent change in portfolio value for the quarter was 3.8%.
2. **Overview of Co-Investments.** Co-investments are direct investments in portfolio companies alongside private equity fund managers. The

investment involves minority ownership positions, and are made on the same terms as fund manager, except with limited governance rights.

Co-investments add incremental returns to the overall private equity portfolio, with a targeted return of 20+%. Overall costs are reduced because managers generally offer co-investments with no fees or carried interest. It also leverages existing relationships, as managers offer their limited partners (LPs) co-investment opportunities/

The Investment Committee proposed that the Board consider allocating up to 10% of the private equity portfolio to co-investment opportunities, around \$25 million per year. This would build a diversified portfolio of investments across managers, sectors, and time. Additional due diligence is on-going.

XII. **Operations Committee Report.** Mr. Lester gave a report on the Operations Committee meeting.

A. **Benefit Development.**

1. **Carryover from 2011 Session.**

- a. **College Participation in ATRS after Act 513.** ATRS staff received input about college participation after the 2011 session. There was a request related to certain colleges that decided to continue participation in ATRS wanting the option to allow any new hire to participate in ATRS. With the passage of Act 513, ATRS participation is only available to those who are currently vested in ATRS at the time of the new employment.

The original reason for the five year vesting requirement was due to the fact that the University of Arkansas (U of A) System employers used that rule for new employees since a law did not require U of A participation and the U of A participated only as an educationally related institution. Due to this volunteer aspect of the U of A participation, the U of A set some limits, including the requirement for vesting, for a new employee to participate in ATRS. Since the U of A has declined to participate in ATRS after the passage of Act 513 of 2011, ATRS staff agrees that it is reasonable to allow participating colleges to allow any new employee to choose ATRS. Senator Key has requested that ATRS Staff and Board research this issue.

The Operations Committee requested that ATRS staff look into developing a change for Act 513 to allow new hires enrollment in ATRS without the vesting requirement.

- b. **Employer Reporting Disclosure for all Salaries Paid.** This carryover item was the House Bill by Representative Pennartz on theft of funds by an ATRS member while employed at an ATRS employer. ATRS was able to work with Representative Pennartz to develop an amendment that achieved much of her intent, complied with the federal law, and ensured that ATRS employers had a duty to disclose all salary payments and salary changes that occurred. Correct salary is important in order that ATRS can ensure its records are accurate, and that ATRS obtains contributions on all salary as defined by Arkansas law. The amendment was not heard in the 2011 session. Since this is a carryover from the 2011 session, ATRS staff wanted to place this on the agenda for any Board input concerning the issue.

The Operations Committee requested that ATRS staff continue to look into this issue

2. **Planning for 2013.** ATRS staff has been discussing potential areas of ATRS law that could lead to cost savings and efficiencies. One focus will be the area of reciprocity between ATRS and the various retirement systems. In addition, ATRS staff will be looking at salary issues, the definition of salary, anti-spiking protection, opportunities to hold more T-DROP funds, return to work, and other areas.

The Operations Committee requested that ATRS staff look into reducing T-DROP deposits by making members choose annuity options (A, B, or C) when the members enter T-DROP.

B. Potential Rule Changes.

1. **Proof of Service Credit (Partial Day Employees) (Policy 7-2).** Educational training of bookkeepers and the new 160 days for a year of service requirement have caused bookkeepers to review how crediting a day of service is made. This has led to unintended consequences for school employees who work a regular daily pattern, such as driving a bus, custodial service, or lunchroom duty while working a varying daily schedule of between three and five hours. Some of these employees now receive fewer days of service than for the same work schedule from the past. ATRS staff would like to propose a rule to prevent the unintended consequence and maintain the status quo that existed historically on such service.

- 2. Purchase of Service Credit (Death of Active Member) (Policy 8-1).** Currently, if a member dies while in active service and has a service purchase account, the policy does not specify what party, if any, has the right to cancel the service purchase agreement, to pay off the service purchase agreement, modify the agreement, or how long an option to make such a decision exists. The ATRS proposal on this item is that the named beneficiary, the spouse, or a lawful representative of the deceased member's estate will be given the opportunity to decide whether to complete a service purchase, modify a service purchase agreement, or end the service purchase agreement. In addition, this proposed rule would provide that unless action is taken within six months of the death of a member, the service purchase account would be cancelled. Additionally, the rule could provide that if additional time is needed to study the issue, ATRS could grant an extension of time for good cause shown. The purpose of the six month requirement is that ATRS could close purchase agreements versus having them open for five years where potential changes could be made that would affect ATRS operations and payments.
- 3. Annuity Options and Disposition of Residue after Retirement (Status Change of Incapacitated Child) (Policy 9-7).** A recent member issue has prompted the request for a revision to ATRS' annuity options policy. If a member elects to cover an incapacitated child as an option A beneficiary (100% survivor annuity) or option B beneficiary (50% survivor annuity) beneficiary, most likely the intent is to provide benefits for that child throughout his or her lifetime with the spouse named as guardian of the child. If a court later determines that the child is no longer incapacitated, or the incapacitated child is emancipated through marriage, there is no provision for allowing the retiree to pop-up to straight life annuity or to name his or her spouse as the option beneficiary. This is not likely to happen very often, and could harm the spouse in such a case. This policy change would cover this rare occasion.
- 4. ATRS Cash Balance Account Options at ATRS for T-DROP Distribution (Cash Account at ATRS) (Policy 10-3).** ATRS staff has performed preliminary reviews on whether ATRS should allow a cash balance account to be left at ATRS when a member retires from T-DROP. For instance, a member might annuitize one-half of his or her T-DROP account balance to obtain a higher monthly benefit and leave the other half in an interest bearing cash account much like the member would do if the balance were rolled out to another administrator. ATRS staff is ready to get more clear guidance from the Board on this potential opportunity for members.

5. Other Rules or Areas of Interest to Committee Members.

- C. Final Completion of Rules Review – No Changes Since Last Committee and Board Approval (Resolution No. 2011-30).** The process for approval of rules changed significantly in the 2011 session. The ATRS Board approved the rules in final form on August 8, 2011. Thereafter, based a new Legislative Council rule, the rules were reviewed by the Public Retirement Committee before the Rules and Regulations Subcommittee of Legislative Council would review the rules. The rules then had the standard review by the Rules and Regulations Subcommittee of the Legislative Council. The full Legislative Council accepted the Subcommittee's report. Although the rules were adopted in final form by the ATRS Board on August 8, 2011, and no changes were made thereafter, ATRS staff has placed the rules back on the agenda for one final approval after all the reviews. Several changes were made in the last session on the use of emergency rules and the timing for the official rules to become effective. Based upon all of the changes, the ATRS emergency rules expire on October 28, 2011, and the final rules become effective on November 11, 2011. However the timing difference has no impact on benefits or operations of ATRS due to the timing of payments and meetings.

Mr. Lester *moved to adopt* Resolution 2011-30, adopting the final amended rules. Mr. Stubblefield *seconded the motion*, and the Board *unanimously adopted the resolution*.

XIII. Staff Reports.

- A. Medical Committee Reports.** Mr. Ray gave the Medical Committee reports for August 2011, September 2011, and October 2011. In August 2011, nine applicants were considered, eight were approved, and one was denied. In September 2011, 19 applicants were considered, 18 were approved, and one was denied. In October 2011, 14 applicants were considered and all 14 were approved.

Ms. Nichols *moved to approve* the August 2011, September 2011, and October 2011 Medical Committee reports. Ms. Coleman *seconded the motion*, and the Board *unanimously approved the motion*.

XIV. Other Business.

XV. Adjourn.

Mr. Lester *moved to adjourn* the Board of Trustees Meeting. Ms. Morey *seconded the motion*, and the Board *unanimously approved the motion*.

Meeting adjourned at 2:33 p.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Amy Glavin,
Recorder

Date Approved