MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING

Monday, December 3, 2012
1:00 p.m.
1400 West Third Street
Little Rock, AR 72201

ATTENDEES

Board Members Present
Dr. Richard Abernathy, Chair
Jeff Stubblefield, Vice Chair
Lloyd Black
David Cauldwell
Kathy Clayton
Hazel Coleman
Wes Goodner, designee for Honorable Martha Shoffner
Peggy Gram, designee for Honorable Charlie Daniels
Danny Knight
Bobby Lester
Donna Morey
Robin Nichols
Janelle Riddle
Brent Taylor, designee for Candace Franks

Board Members Absent
Dr. Tom Kimbrell

Consultants Present
Judy Kermans, Gabriel, Roeder, Smith & Co
Brian Murphy, Gabriel, Roeder, Smith & Co

Reporters Present
Mike Wickline, Arkansas Democrat Gazette

ATRS Staff Present
George Hopkins, Executive Director
Gail Bolden, Deputy Director
Kay Daniel, Director's Assistant
Dena Dixson, Internal Audit/Risk Mgmt
Mitzi Ferguson, Chief Fiscal Officer
Laura Gilson, Chief Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Clementine Infante, Attorney
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Michael Ray, Dir. Member Services
Gaye Swaim, Operations Administrator
Brenda West, Internal Audit/Risk Mgmt

Guests Present
Bill Brazil
Jody Carreiro, Obsorn, Carreiro, & Assoc.
John Estes, Superintendent, Palestine-Wheatley School District
Sarah Ganahl, Bureau of Leg. Research
Erika Gee, Attorney General's Office
Jorge Perez, Div. of Legislative Audit

I. **Call to Order/Roll Call.** Dr. Abernathy, Chair, called the Board of Trustees meeting to order at 1:01 p.m. Roll call was taken. Dr. Tom Kimbrell was absent.

II. **Motion to Excuse Absences.**

Ms. Nichols *moved* to *excuse* Dr. Tom Kimbrell from the December 3, 2012, Board of Trustees Meeting. Ms. Coleman *seconded* the *motion*, and the Board *unanimously approved the motion.*

III. **Adoption of Agenda.**

Ms. Coleman *moved* for *adoption* of the Agenda. Ms. Riddle *seconded* the *motion* and 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. **Preliminary Active Actuarial Valuation.** Ms. Kermans and Mr. Murphy of Gabriel, Roeder, Smith, & Company presented the preliminary active actuarial valuation. The funding objectives for ATRS are intergenerational equity with respect to plan costs, a stable pattern of contribution rates, and a ratio of assets to liabilities at 100%. To meet these objectives, ATRS needs reasonable forecasts of resources and obligations, smoothing devices, funding discipline, and a sound investment program.

The agency is 71% funded, down from 72% in 2011. The amortization years grew from 66 in 2011, to over 100 in 2012. The increase is due to the market value of assets rate of return of 1.08%, compared to the assumed 8% return, the final phase-in of the losses in 2009, and current and prior investment losses more than offset any gains. Unless there is a substantial investment gain in 2013, the amortization period is like to remain at over 100 years in the next valuation. Based on the June 30, 2012, valuation, an employer contribution rate of 16.8% of payroll would be needed to return the amortization period to 30 years.

Mr. Lester *moved* to *approve* resetting the actuarial value to real value. Ms. Nichols *seconded* the *motion*, and the Board *unanimously approved the motion.*

VI. **Member Appeals.**

A. Bobby Fingers – Palestine-Wheatley. Ms. Gilson presented the Bobby Fingers – Palestine-Wheatley appeal. Ms. Fingers had sued Palestine-Wheatley over employment issues and won. Palestine-Wheatley paid a settlement, but refused to pay contributions owed on Ms. Fingers to ATRS, as they interpret ATRS law to say that the contributions should come out of the settlement paid. The Hearing Officer reviewed the facts and the law and upheld the ATRS Executive Director's decision that Palestine-Wheatley should pay contributions on Ms. Fingers.

Mr. Knight *moved* to *affirm* the Hearing Officer's decision in the matter of the Bobby Fingers – Palestine-Wheatley appeal. Mr. Black *seconded* the *motion*, and the Board *unanimously approved the motion.*

VII. **Statement of Financial Interest.** Mr. Hopkins reminded the Board about the annual statement of financial interest. ATRS Trustees must file a Statement of Financial Interest by the end of January 2013, for their financial information for calendar year 2012.

VIII. **Proposed 2013 Board of Trustees Schedule.** Mr. Hopkins presented the proposed 2013 Board of Trustees meeting schedule for Board review.

IX. **Report of Member Interest Waived under A.C.A. Sec. 24-7-205.** Mr. Hopkins presented the member interest amount waived report. ATRS waives interest on members when there is a dispute between ATRS and the member as to whether ATRS made a mistake or otherwise did not do all that was required on the member's account. There were no waivers to report.

X. **Report of Employer Interest and Penalties Waived under A.C.A Sec. 24-7-411.** Mr. Hopkins presented the employer interest and penalties waived report. ATRS may waive employer interest and penalties when reports/payments are late or have issues due to new bookkeeper, sickness, etc. ATRS has recently been converting from a paper report to an electronic report. ATRS staff is pleased to report that ATRS is in the process of converting most ATRS employers from a paper check contribution payment to an electronic funds transfer (EFT) payment. There were no waivers to report.

XI. **Audit Committee Report.** Ms. Nichols gave a report on the Audit Committee meeting.

A. **Internal Audit Report: Member Records/T-DROP.** The audit was to verify the accuracy of T-Drop deposit calculations, and disbursements to determine compliance with policies, procedures, and regulations. We did note incorrect status codes on three members. The status codes did not cause any problems with T-Drop deposits, interest or disbursements. Arkansas Teacher Retirement Member Information System (ATRMIS) has been updated with correct status codes and the Agency is developing a report to assist them in their review of the status codes. Audit objectives were achieved and no audit findings were identified. Therefore, no recommendations were issued.

XII. **Investment Committee Report.** Ms. Nichols gave a report on the Investment Committee meeting.

A. **Arkansas Real Estate Update.**

1. **Halderman Farmland Update.** Halderman and ATRS have been cautious about developing a farmland purchase strategy. ATRS currently has approximately $40 million worth of farmland spread over several markets. Despite the U.S. suffering its worst drought in over 50 years, ATRS farmland yielded a 2.51% return on equity invested. Land value has increased 10%-15% throughout the U.S. agriculture regions. Halderman and ATRS will continue to be cautious about farmland purchases in 2013.

B. **General Investment Consultant Update – Hewitt EnnisKnupp.**

1. **Portfolio Performance Update for the Quarter Ended September 30, 2012, Final.** The total fund slightly underperformed the benchmark of 4.5% at 4.2% for the quarter. Manager underperformance contributed the fund trailing the benchmark by 30 basis points. HEK is currently working on strategies to address the underperformance.

2. **Relational Investors, Fee Reduction, Slightly Larger Investment Universe.** Relational Investors has asked for permission to expand the universe of stocks in which it invest and unilaterally agreed to reduce its management fees for the ATRS portfolio. Since this is an adjustment rather than a change, no Board action is necessary.

C. **Real Estate Investment Consultant Update – Hewitt EnnisKnupp.**

1. **2013 Real Estate Pacing Schedule.** ATRS is nearing its 10% target for real estate allocation. HEK recommends committing $80 million to real estate in 2013 to maintain the target of 10% for real estate investments.

   Ms. Nichols *moved* to *approve* the Hewitt EnnisKnupp 2013 Real Estate Pacing Schedule. Mr. Stubblefield *seconded* the *motion*, and the Board *unanimously approved the motion.*

D. **Private Equity Investment Consultant Update – Franklin Park.**

1. **Recommendation to Commit up to $25 Million to EnCap Energy Capital Fund IX, L.P. and to Use Imminent Need Funding.** The fund is being formed to make control equity investments in oil and natural gas exploration in the U.S. and Canada. Franklin Park recommends a commitment of up to $25 million to EnCap, subject to satisfactory negotiation of the final document, because of EnCap's brand and relationship with local management teams, the investment team is

experienced and cohesive, and EnCap's track record is attractive and deep.

a. **Resolution 2012-39.**

Ms. Nichols *moved* to *adopt* Resolution 2012-39, approving a commitment of up to $25 million EnCap Energy Capital Fund IX, L.P. and to use imminent need funding. Mr. Knight *seconded* the *motion*, and the Board *unanimously adopted the resolution.*

2. **Imminent Need Funding for Franklin Park Co-Investment Fund, L.P. of up to $20 Million That was Approved on November 15, 2012.** Co-investment opportunities between now and the next meeting of Legislative Council may require more funds than the current commitment of $20 million dollars. To ensure that no investment opportunity is missed, the $20 million dollars approved in November should be converted to an imminent need commitment.

a. **Resolution 2012-40.**

Ms. Nichols *moved* to *adopt* Resolution 2012-40, approving the use of imminent need funding for Franklin Park Co-Investment Fund, L.P. Ms. Riddle *seconded* the *motion*, and the Board *unanimously adopted the resolution.*

XIII. **Operations Committee Report.**

A. **Potential Rule Changes.**

1. **Policy 9-7 Annuity Options and Disposition of Residue After Retirement.** The rule on disbursement of the final retirement payment upon the death of the last payee lacks clarity. Currently, it reads, "benefits are payable through the month in which the last option beneficiary's death occurs." For the purpose of this rule, both the member and the designated Option A or Option B beneficiaries are considered option beneficiaries. There was some confusion by staff that only option beneficiaries' final benefit payments were to be returned to the ATRS trust if the payments were not deliverable through the normal manner paid prior to death. Based upon Board instruction at the November 15, 2012, Board meeting, ATRS staff prepared two versions of Policy 9-7 for the Board to review. The staff will use the version selected by the Committee and approved by the Board, or will draft any other version as directed by the Committee.

a. **Version 1 - Final Benefit Payment Left in ATRS Trust if Undeliverable.** With written clarification by executive staff, both the member's final benefit payment and the option beneficiary's final benefit payment are currently returned to the ATRS trust if the payment is not delivered in the normal manner paid prior to death.

b. **Version 2 - Final Benefit Payment Distributed to Beneficiaries if Undeliverable.** The Board instructed staff to draft a version that says ATRS will deliver the last payment in the normal manner paid prior to death. If the payment could not be delivered in the normal manner, the member's residue beneficiary or beneficiaries would receive the payment if a residue beneficiary was designated. If no residue beneficiary is designated or if the residue beneficiary or beneficiaries predecease the member or option beneficiary, then the final benefit payment would be payable to the member's lump sum death beneficiary or beneficiaries. If the final benefit payment is neither payable to the residue nor the lump sum death beneficiaries, the final benefit payment will be made to the member's estate unless it is impractical to make the payment to the member's estate. If it is impractical to make the payment to the member's estate, then the final benefit payments shall be forfeited to the trust assets of the system.

Mr. Lester *moved* to *approve* Policy 9-7 Annuity Options and Disposition of Resident After Retirement, Version 2 – Final Benefit Payment Distributed to Beneficiaries if Undeliverable. Mr. Black *seconded* the *motion*, and the Board *unanimously approved the motion.*

2. **Policy 9-4 Disability Retirement.** ATRS rules state that if a member on disability retirement returns to work under an ATRS covered employer, they immediately become an active member and their disability retirement is cancelled. It has come to ATRS staff attention that a disability retiree is able to work indirectly for ATRS covered employers through LLC's and still draw disability retirement. ATRS staff recommended that disability retirees not be allowed to return to indirect employment for an ATRS covered employer in a manner that the member has substantial control of the employee/employer relationship, such as being a material owner of the contractor. The Board voted to move forward with this rule change at the November 15, 2012, Board meeting.

Mr. Lester *moved* to *approve* Policy 9-4 Disability Retirement. Ms. Gram *seconded* the *motion*, and the Board *unanimously approved the motion.*

B. **Opportunity for Board to Review Its Internal Rules for Additions, Amendments, or Deletions.** The Operations Committee received a copy of the internal rules and regulations, and will review them for any changes that need to be made. The Committee decided it will table this item until the next Operations Committee meeting.

C. **Law Changes Approved by the Board Since 2011.**

1. **Purchase of Service Credit After Reinstatement.** Based upon Board discussions, it appears that significant policy issues are involved in the termination of a school employee and subsequent required reinstatement. The policy questions are how service credit and other factors should be resolved in this circumstance. The ATRS Board has determined that members/employers should be allowed to purchase service credit during periods of termination and subsequent reinstatement at the actuarial cost of service.

2. **Allow New Employees of Colleges to Join ATRS.** ATRS staff has received input about college participation following Act 513 of the 2011 session. One request related to certain colleges that have decided to continue participation in ATRS wanting the option to allow any newly hired employee to participate in ATRS rather than limiting ATRS participation to only those with five (5) or more years of service in ATRS at the time of the new employment with the ATRS participating college.

   The original reason for the five (5) 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 at the beginning of employment.

3. **Rule Making Authority to Allow ATRS to Collect Necessary Information From ATRS Employers to Properly Record Salary and Service Credit Records.** Another carryover item from the 2011 session was the House Bill by Representative Pennartz on theft of funds by an ATRS member while employed at an ATRS employer. Correct salary and service credit records are 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, and the ATRS Board and staff wanted to be sure this bill is heard in the 2013 session. Due to the ever-changing issues that arise, the proposal would now give the ATRS Board authority to designate required information to be provided by employers using the Board's rule making authority.

4. **1% T-DROP Reduction for Noncontributory Service.** Currently, ATRS has a 1.0% reduction in the T-DROP deposit formula for each contributory year of service credit that a member has with ATRS; and a 1.0% reduction for each reciprocal year of service credit a member has with another system, regardless whether the year is contributory or noncontributory. ATRS only has a 0.6% reduction for each noncontributory year an ATRS member has with ATRS. This means that if a member had thirty (30) years of contributory service credit and no noncontributory service, then the member would receive a deposit each month into their T-DROP account equaling 70% of what the retirement benefit would have been, had the member retired.

   A member with thirty (30) noncontributory years of service credit would receive 82% of what the monthly benefit would have been had the member retired. In this instance, that would provide the noncontributory member with the same number of years of service with a 12% advantage over the contributory member. For clarity and ease of administration, a 1% reduction for all service types would be easier to administer and explain. In addition, this "advantage" does provide some disincentive for a member who is noncontributory to elect to become contributory while an active member of ATRS.

   In addition, requiring a 1% reduction for all service credit types would be a cost savings since a noncontributory member would receive the same T-DROP deposit reduction that a contributory member receives. In cases where a member has mixed service, it would be easier to compute at ATRS and clearer to the member what the reduction would be.

5. **Disability Benefit Paid Only Back to Date the Completed Application is Filed.** Currently a member can obtain a quarter year of service credit in a fiscal year and if the member has a medical condition, the member can wait up to eighteen (18) to twenty-two (22) months before filing an application for disability benefits. If the disability application is approved, the member is paid disability benefits back to the first month he or she didn't work, even if that were twenty-two months before the date the application was filed. In order to encourage members to file a disability application in a timelier manner, and to prevent members from constantly missing the filing deadline, ATRS staff feels that often both the member

and ATRS are disadvantaged by paying disability benefits back to the time the member last worked. The delay is often caused due to interaction between the ATRS disability benefit rules and a private disability policy. Many private disability policies reduce the private disability benefit once ATRS begins to cover the member with an ATRS disability benefit.

6. **Require Five (5) Years of Actual ATRS Salary for Disability and Survivor Benefits.** Currently ATRS allows a disability or a survivor application once a member has completed five (5) years of combined ATRS and reciprocal service. If an ATRS member has worked in the APERS system for seven years, in this example, and later works for one half year in ATRS, that member would be entitled to an ATRS disability benefit, if the conditions for disability retirement are met. The disability benefits might be quite small at ATRS, but it would still require the full Medical Committee review with benefits paid each month.

   In addition, if the same circumstance existed as above and the member died, ATRS would pay the survivors of a new member with one half year of service credit the same benefit it would pay a member with thirty (30) years of service in ATRS. ATRS would pay up to 60% of that new member's best salary (the salary that would have been paid in that fiscal year) to the member's minor children until the minor children reach age twenty-three.

   The survivor benefit is a very lucrative benefit. ATRS staff feels as a cost savings, that perhaps a member should have a greater connection to ATRS before disability or survivor benefits are paid than just a small amount of service. This proposal would be a cost savings and would also ensure that the funds of ATRS are appropriately directed for the benefit of members after an appropriate length of recognized service at ATRS employers.

7. **Define Pensionable Salary.** ATRS has a very liberal definition of salary. Often changing the definition of salary can be a method of cost savings by ensuring that only reasonable "pensionable salary" is actually included in the determination of final average salary. For instance, it may be possible for a home provided by an ATRS employer to be included as salary on that member's W2. If it is included on the member's W2, ATRS will treat the amount as salary. The same is true for cell phones, vehicles, sick days, annual leave, and the like. ATRS should tighten up the definition of salary that is currently used in the calculation of final average salary at ATRS.

8. **Final Average Salary and Reciprocal Service.** While reciprocity was designed to support mobility in state retirement systems without greatly injuring retirement benefits, there are certain aspects of combining reciprocal service which encourage anti-selection. One of the anti-selection features that ATRS has identified is the calculation of final average salary (FAS) between the state retirement systems. The ATRS law currently provides that ATRS will use the final average salary that is the higher of the reciprocal systems involved.

   Each system is responsible for the calculation of its final average salary. ATRS' rules and procedures concerning reciprocal final average salary are that ATRS will use the highest final average salary of ATRS or the reciprocal system. For example, if a member has 27 years of service with ATRS and a final average salary of $40,000, that member can take a position covered by APERS, work one year for a salary of $60,000, and the member's 27 years of service at ATRS will be calculated with $60,000 as a final average salary. ATRS sees this as a problem that can be easily remedied by ATRS using some of its salary years in the FAS calculation if the member has less than 3 years with the reciprocal system that has a higher FAS than ATRS.

9. **Ability to Retain Investment Consultants and Money Managers, Custodian Banks, etc., Without Periodic Review.** Arkansas procurement law anticipates that vendors such as computer service vendors and other vendors should have contracts that expire from time-to-time in order to seek more competitive proposals and to ensure competition for services, which often reduce fees.

   The investment processes of ATRS are significantly different in that ATRS often hires a money manager and will retain that money manager for decades until such time as the money manager fails to perform as expected or otherwise the ATRS Board determines that a change should occur. After Act 1211 of 2009, all private equity and real estate managers are exempt from procurement except through the specific process of Act 1211 which provides that ATRS will present these investments to the Legislative Council for review. ATRS uses consultants to perform the due diligence and recommendation on these type investments.

   ATRS staff will work on legislation with the other retirement systems, along with the Department of Finance and Administration and others, to place other money managers that do not operate in funds, into the same one time review process, in order to prevent the concern and cost of engaging in an RFP/RFQ for a money manager who is currently managing money and has a low fee structure. It is often misunderstood and can

lead to confusion by those thinking ATRS may be about to change a money manager and by the money manager thinking ATRS is dissatisfied with what is often a quality performance. A money manager can also use the process to increase fees that ATRS pays.
Instead of requiring a money manager to go through an approval process every seven (7) years, it seems a better approach to allow the ATRS Board and the ATRS consultants to continue determining which money managers are making the grade and terminating those that are not, instead of requiring a full review every seven (7) years. ATRS would also like to determine whether the same approach should be considered for the ATRS custodial bank, actuaries, investment consultants, and law firms. Some of these other groups may be more problematic in terms of this approach but ATRS will check with the Attorney General, Department of Finance and Administration, the Governor's Office, Legislators, and others to determine if this is a reasonable approach on relationships that ATRS has historically maintained over many years. Even if ATRS undertakes this process, all of these contracts would be up for review every two (2) years but would not require an RFP/RFQ process when the current maximum length of time for a contract has been met.

10. **Define Manifest Injustice.** As ATRS continues to try to work through years of various processes and procedures that often have legal compliance concerns, ATRS is lacking a broader definition of manifest injustice.

    For instance, in the review that was undertaken by the ATRS Internal Auditor, the process of how ATRS handles Act 793 of 1977 claims, and how ATRS handles Act 808 of 1987 claims, have resulted in the ATRS executive staff determining that ATRS has incorrectly paid lump sum death benefits to beneficiaries of members retiring under both Acts 793 and 808. The total amount paid from the beginning of this process has not been determined. Since July 1, 2007, the beginning of the look back period established in 2011, $380,000 in lump sum death benefits have been paid that should not have been paid, according to the ATRS executive staff's determination.

    If ATRS continues along its regular process in this regard, ATRS would find all the existing beneficiaries of these lump sum death benefit payments and seek repayment. Some of the payments went to estates which are no longer subject to collection. Others have died since the payment was made and are not subject to collection due in many instances. Others may have circumstances where income tax was paid on the payment. If ATRS seeks recovery of the full amount, then a great unfairness would result.

ATRS ceased paying the lump sum death benefits while the executive staff made a thorough review. Lump sum death benefits have not been paid for about eight (8) months, while ATRS executive staff processed the issues and legal circumstances of these two special and complex acts.

ATRS staff believes the appropriate action is to seek legislation that would allow ATRS to write off these sums as a specific manifest injustice declaration under the law. In addition, ATRS staff feels that with appropriate guidance from the Board, if these type issues arise in the future, instead of having special legislation each time, a new law could be passed to give ATRS greater discretion than currently exists.

ATRS staff will work with the Board to develop a more flexible definition of manifest injustice in the law to address these issues at a Board level without waiting two (2) years in the event a new issue such as these Acts 793 and 808 payments are discovered. All the recipients of death benefits through Acts 793 and 808 are innocent recipients who should not be adversely affected due to an interpretation mistake at the ATRS staff level over a decade ago on very complicated and vague acts.

In addition, at times a manifest injustice may be found if a member misses a deadline due to a communication issue or mistake by ATRS staff. Although it provides significant extra duties on ATRS staff and the Board, another issue on manifest injustice may be considering allowing a filing deadline to be extended due to manifest injustice circumstances. Although such authority should be greatly limited, it could be foreseen that a person injured in a car accident or similar circumstance, with a pending deadline, could be given additional time if it is established that they were incapable of filing the documents at the time the document was due, although they had intended to do so before the deadline. An extension could also be allowed if ATRS staff gave incorrect written advice.

11. **Standardize Interest Rates on All Funds Due to ATRS.** Currently, ATRS has a fairly good record of obtaining employer contributions and member contributions from ATRS employers. With the development of charter schools, at times, ATRS has had occasional difficulty collecting both member and employer contributions from a few charter schools. ATRS proposes that contributions, that are not paid timely, accrue interest at 8% per annum, to treat the funds as if they had been in the ATRS portfolio and receiving the assumed rate of return. Currently these sums are at a 6% interest rate.

12. **Add Penalty for Failure to Remit Current Year Contributions After One (1) Month's Notice to Employers.** In order to give ATRS greater authority in obtaining reports and contributions, ATRS staff proposes that once a report becomes significantly late, an additional penalty, in addition to the late penalty that exists today, be added. ATRS staff suggests the amount of approximately $500.

13. **Satisfy Employer Debt by Deducting from the General Operation Funds of the Arkansas Department of Education.** ATRS has had difficulty receiving both employer and member contributions from certain charter schools that have ceased to exist in getting all contributions due for both employer and member contributions. For various reasons, some employers fail and refuse to pay sums due to ATRS. ATRS has a provision in its law that certain sums can be obtained from the state government for these employers. However, it has been determined that money no longer flows to public school employers in the way anticipated by the original law; therefore, that law is no longer effective.

    ATRS staff is working with the Department of Education and others to create a specific process and mechanism in the law for funds due from public schools and charter schools be subject to payment from operation funds administered by the Department of Education in the event the money is not paid directly. This will eliminate a lot of administrative difficulty and provide effectiveness in the law in order that ATRS could be better assured of getting the required contributions.

14. **Allow Retirees Who do not Retire on the First Day of a Calendar Quarter to Use Current Year Salary in Final Average Salary if it is One of the Highest Salary Years.** Currently, if a member does not retire on a July 1, an October 1, a January 1, or an April 1, that member's final year's salary cannot be included in the determination of final average salary if the member retires in the final year of work.

    ATRS also imposes a service penalty for someone retiring in the last year when they are active, to prevent members from leaving school early, by only allowing completed quarters of the year to be reflected in service credit. For instance, a member retiring on January 1, while still in active service, can only receive a half-year of service credit since the fiscal year is one-half over in January, even if they had worked 160 days. The same is true for a quarter year on October 1, and three-quarters of a year on April 1.

    ATRS staff thinks the service penalty is enough to prevent retirements which would leave a school district in a lurch. ATRS thinks it is

appropriate to allow a member who is retiring on the beginning of a month other than the four quarters to receive salary credit for the existing year if the salary could otherwise be used in the calculation of final average salary.

15. **Members With 28 Years of Service or 60 Years of Age Cannot Apply for Disability Retirement.** Currently, a member who has reached age sixty (60) or who has over twenty-eight (28) years of service credit has an incentive to forego regular age and service retirement and obtain disability retirement. The member who retires under age and service retirement is limited to service credit for the pro rata year of service credit worked in the last year of employment. A member who is approved for disability retirement and has 160 days of service credit can retire at any time during the last year of employment and receive a full year of service credit instead of being limited to the number of completed quarters of the last year of employment. ATRS sees several members choose to go through the disability retirement process and add the administrative cost to ATRS, when they could have retired as a regular age and service retiree. This process often gives a small increase to their benefit of up to a half-year of service credit. This simple change will provide that if a member is eligible for age and service retirement, then they cannot apply for disability retirement at ATRS to take advantage of this loop hole.

16. **Survivor Benefits Become Effective the Date of the Completed Application.** ATRS typically finds deceased members very quickly and notifies the family/beneficiaries about ATRS programs and benefits. For various reasons, at times, survivors and others wait long periods of time without claiming the survivor benefits that they know exists. It is uncertain the motivation for these decisions but it is not uncommon for these to occur. At one time, high interest rates by ATRS were a part of the reasoning. The proposal is that survivor benefits begin after the effective date the completed survivor application is properly filed with ATRS to prevent large back payments.

17. **Require Litigation Filed as a Result of Member or Employer Appeals to be Filed in Pulaski County.** The ATRS appeal process has been working well for ATRS, its employers, and members. The appeal process works like this: if a member or employer disputes something a staff member has determined, then the staff member writes a staff determination letter. The member then has 30 days to appeal the staff determination to the executive director. The member's file is thoroughly reviewed again by executive staff in what is called a "de novo" review.

It is a new review of the issue from the beginning. The member is given 30 to 35 days to present any additional information that the member feels is relevant to his or her case prior to the executive director review. An executive director review letter is then sent to the member. If the member does not agree with the results of the executive director review, then an appeal is brought before the Board of Trustees. This administrative appeal is handled by the ATRS legal staff and a hearing officer that is totally neutral to the case.

The hearing officer hears both sides of the case and issues a proposed order. The Board may accept the proposed order; reject the proposed order; modify the order; make its own finding of fact and conclusion of law and issue its own order based upon those findings and conclusions; or remand the order in whole or in part to the hearing officer for reconsideration or for additional finding of fact and/or additional conclusions of law. Any member receiving an adverse ruling from the Board retains certain rights under the Arkansas Administrative Procedures Act to file for a judicial review.

ATRS has had one such case that has been litigated under this provision in Faulkner County. This requires the ATRS legal staff to travel to another county to attend hearings and to make legal filings with the Faulkner County Clerk. While Faulkner County is not very far from Little Rock, ATRS staff is concerned that a judicial hearing may be held in a county much farther away from Little Rock. This proposed change will be to have hearings under this provision held in Pulaski County.

18. **Discounted Buying of Inactive Vested Service Credit.** ATRS staff continues to look for ways to address the liabilities on the ATRS balance sheet. Currently, the ATRS liabilities in total include liabilities of about $700 million dollars to members who are, or will become inactive vested members. This means that over 4% of the ATRS liabilities are to members who are no longer on a career path and are no longer involved in delivering the educational curriculum to Arkansas schools.

    Many of these people also wish to cancel their service and obtain an immediate payment versus being entitled to receive a monthly retirement benefit that may not occur for 20 or more years into the future. Members who are totally contributory have somewhat of an option now, and that is to obtain their contributions plus interest. Those with mixed service of contributory and noncontributory can do the same. Those that are totally noncontributory have no method of cashing out their service for an immediate payment. This brought ATRS staff to look at a potential program of allowing all these members to have an occasional opportunity

granted by the ATRS Board opening a window for these members to exchange their right to a benefit in the future for an immediate cash payment now to take these liabilities off the ATRS books at a discount.

The inactive member often wants an opportunity to sever their relationship with ATRS in return for money that can be rolled into an IRA, or otherwise available for the inactive member to use. It can be beneficial to ATRS because these reserve accounts can be eliminated for significantly less than the current reserve value, and the reserve accounts value will not continue increasing annually as these members get closer to age 60. Over time, ATRS may be able to trade some cash payments to reduce hundreds of millions of dollars in liabilities. That reduction can assist ATRS in addressing its funding levels.

This proposed legislation will require Board action from time-to-time to open a window for these discount liquidations. In some instances, these members are more than 20 years away from having a benefit and would be anxious to obtain something now rather than wait that amount of time for a benefit. This program would be totally voluntary, meaning that members who did not want to cash in their rights for future benefits would just decline to participate in the opportunity provided by ATRS.

19. **Permanently Delete Service Credit on Years on Which Employee Contributions Are Owed.** ATRS finds that many members owe contributions on service credit from many years ago which has accrued significant amounts of interest. These members are usually found at the time of retirement. ATRS' current policy is to hold up retirement payments until the balance is paid in full. This creates a hardship on many retirees who do not have money readily available to pay off those accounts. ATRS staff previously recommended drafting legislation that deletes the years in question after sending notices to the member about contributions owed. If the member paid partial contributions on the year or years in question, ATRS would refund the contributions to the member without interest. The Board showed previous interest in this proposed law change as a voluntary measure for members. ATRS staff wanted clarification from the Board before drafting legislation.

20. **Contract Buy Out, Settlement Agreements, Court Ordered Payments, Contract Won Through Litigation, Judgment or Decree. Staff Recommendation to Replace All Other Approved or Discussed Proposals.** ATRS staff proposed that ATRS consider any salary that is reported under the IRS guidelines of W2 income that is reported to ATRS within 30 days of an accepted contract buy-out, settlement agreement, final court ordered payment, contract won through litigation, judgment, or

decree will be treated as salary for the purpose of paying ATRS benefits. If the member is contributory, the mandatory 6% withholding must be reported on the salary. The employer contribution must be paid on the reported salary. Service credit shall be for the time actually worked. This salary shall not be stacked with W2 salary earned while working the normal duties of the job requirements. ATRS will accept the higher of the two amounts in the final average salary if one should be considered as one of the highest of the final average salaries. Any W2 salary reported after the 30-day cut-off period shall not be treated as salary for benefit purposes, but will require employer contributions. Any time that a member should have been eligible to work as a result of a wrongful termination may be purchased at the actuarial cost of service for the time the service would otherwise have been earned.

21. **Proposal to Provide the ATRS Board with the Rule Making Authority to Properly Implement all IRS Penalties, Restrictions, Limitations, or Requirements to Give the Board the Authority when the IRS Imposes a Member Penalty, Restriction, Limitation, or Requirement to Impose the Minimum Penalty, Restriction, Limitation, or Requirement in Order that the IRS Compliance Have as Small an Impact as Possible on ATRS Members that all Benefits Earned by ATRS Members be Paid When Possible.** In the last four years, ATRS has worked hard to comply with IRS rules, limitations, restrictions, and requirements. At times, members of the General Assembly, employers, and others have suggested that ATRS is too strict in its application. The IRS occasionally does remove a required penalty, loosen a restriction, or make a change in a regulation that will allow ATRS to have a less strict enforcement on its members of IRS regulations. This potential legislative change will allow ATRS to make changes by rule to expedite the loosening of a restriction and will allow ATRS to remain in compliance with the IRS, while at the same time, doing everything possible to minimize tax penalties and other requirements imposed upon ATRS while paying members all benefits possible.

D. **Proposed Law Changes.**

1. **Six (6) Month Separation/Termination for All Retirees.** ATRS staff was directed to find out the exact cost savings of this proposal at the August 6, 2012, Board meeting. GRS has provided a cost savings study on this information. The cost savings of having all retirees go through a six month separation period is one-fourth of a basis point. If this change is considered, ATRS staff proposed to start it a year or two into the future to avoid confusion and mass member retirement.

The Committee tabled this item.

2. **Flexible Vesting Requirements to be Determined by Board.** GRS provided a cost study to evaluate the cost savings if ATRS returned to ten year vesting on future retirees. The cost savings for this proposal would be .16% of payroll. For the small amount of savings, the staff foresees many problems with disability retirement, survivor rights, and reciprocal service credit with other Arkansas public retirement systems that would be cause for concern.

   The Committee tabled this item.

3. **Remove Minimum Benefits From Retirement Benefit Formula.** Some of the potential law changes being studied by the Board will involve reductions in either or both of the contributory and noncontributory multiplier used to calculate retirement benefits. As ATRS began to look at the law for the retirement benefit formula, there is a whole page devoted to minimum retirement benefits. ATRS has minimum benefits that vary between $64 and $150 per month based on status. The law involves members retiring after June 30, 1965 but before July 1, 1986, members who are totally contributory or totally noncontributory, members with at least five years of service credit but less than ten years of service credit and differing amounts if the member has only noncontributory service credit or only contributory service credit, and prorated amounts if a member has a mixture of service credit. In addition, there is a section that states as of 1986, the member contributory benefit program and the member noncontributory program were related by requiring the same employer contribution rate. It was intended that this relationship be preserved by future changes, if any, in benefit programs.

   ATRS staff has determined that 2% to 3% of ATRS members qualify for the minimum benefit amounts each year. The majority of these members are completely noncontributory, and the average number of years of service credit is less than six years. Many of these members select an option to provide for beneficiaries after the member's death. If the minimum benefit provision was removed, ATRS would not only realize a cost savings for the members, but future cost savings on option beneficiaries. Before sending this proposal for actuarial study, ATRS staff wanted to present this to the Board to get a signal of the interest in the proposal.

   Mr. Lester *moved* to *approve* authorizing ATRS staff to order a cost study on savings from removing minimum benefits from the

retirement benefit formula. Mr. Black *seconded* the *motion*, and the Board *unanimously approved the motion.*

4. **Clarification of ATRS Prohibition on Concurrent Enrollment With Other Retirement Plans.** ATRS has historically prohibited concurrent enrollment in ATRS and another state supported retirement plan. The express exceptions in Arkansas Law are for Arkansas legislators and volunteer fire fighters. There is an express prohibition on concurrent enrollment in ATRS and an alternate plan of a post-secondary institution. Other concurrent enrollment has been denied by a code provision that is less than specific but has been interpreted by ATRS for many years to prohibit concurrent enrollment with other public plans. A question by the Division of Legislative Audit has brought this to staff's attention. The staff proposal is to clarify the law to conform to current practice. At the same time, staff would understand if the Board wishes to allow concurrent enrollment by adopting a specific law to authorize it.

   Mr. Lester *moved* to *approve* authorizing ATRS staff to draft legislation clarifying the ATRS prohibition on concurrent enrollment with other retirement plans. Ms. Gram *seconded* the *motion*, and the Board *unanimously approved the motion.*

E. **Anticipated Actuarial Needs and Suggestions Researched by Staff in Preparation for the 2013 Session.** ATRS will need approximately 2.85% of payroll to bring its unfunded liabilities to 30 years, rather than the 2.75% number given at the November 15, 2012, Board meetings. The items listed are available for Board action.

1. **1% Reduction for Noncontributory Service in T-DROP Formula.** The ATRS Board has already approved this item. The cost savings for this item is eight (8) basis points.

2. **Rescind Future Impact of Optional Compounding of the Simple COLA in 2009.** The ATRS Board compounded the simple cost of living adjustment (COLA) in July 2009. Discussion with the actuaries placed the cost of this optional non-guaranteed benefit at about $180 million dollars. If the Board had authority to eliminate the future impact of this future compounding that was optional and voluntary, the current staff estimate is that it would be the equivalent of 50 basis points.

3. **Four Year Final Average Salary Immediately.** The cost savings for this item is 39 basis points. Due to member behavior, the cost savings for this change would be null.

4. **Five Year Final Average Salary Immediately.** The cost savings for this item is 76 basis points. Due to member behavior, the cost savings for this change would be null.

5. **Four Year Final Average Salary in 2019.** The cost savings for this item is 26 basis points. This would be a contingent benefit change, as ATRS could reach the 30 year amortization period before 2019. If that were to happen, the four year final average salary change would not take effect.

6. **Five Year Final Average Salary in 2019.** The cost savings for this item is 50 basis points. This would be a contingent benefit change, as ATRS could reach the 30 year amortization period before 2019. If that were to happen, the five year final average salary change would not take effect. ATRS staff recommended this item because it would not affect any current member behavior but ATRS would receive 50 basis points credit with GRS.

7. **Eliminate $75 Stipend Flash Cut.** Currently most ATRS retirees receive a benefit stipend of $75 dollar per month. The stipend can be eliminated or reduced by legislation. ATRS realizes many retirees are dependent on the added amount of $75 dollars from the stipend each month. The stipend was added to retirees' benefits on July 1, 1999. The original amount of the stipend was $50 per month, and was added to every retiree, survivor, and beneficiary regardless of the amount of service credit. The following year, the stipend was increased to $75 per month, again with no requirements for eligibility. Beginning with retirees on or after July 1, 2001, the eligibility requirement was raised to five years of service credit, and beginning July 1, 2007, the eligibility requirement was raised to ten years of service credit. As the number of retirements has grown, so has the cost of the stipend. The cost savings for this item is 151 basis points.

   The Committee removed this item from consideration by majority vote.

8. **Reduce Stipend to $50.** The cost savings for this item is 47 basis points.

9. **Eliminate $75 Stipend over Three Years.** The cost savings for this item is 139 basis points.

10. **Increase Employer Contribution Rate by 1%.** The cost savings for this item is 100 basis points. The 1% increase would cost the state $28.4 million and could potentially be funded through the Department of Education.

11. **Increase Member Contribution Rate by 1%.** The cost savings for this item is 70 basis points.

12. **Increase Member Contribution Rate by 2%.** The cost savings for this item is 140 basis points.

13. **Change Contributory Multiplier for Future Service to 2.10%.** The cost savings for this item is 24 basis points.

14. **Change Noncontributory Multiplier for Future Service to .75%.** The cost savings for this item is 78 basis points.

15. **Change Noncontributory Multiplier for Future Service to .6%.** The cost savings for this item is 91 basis points. This change would reduce the multiplier from 1.39% to .6%. For noncontributory members to avoid this drastic cut, they could become contributory members at the beginning of the next fiscal year.

16. **Discounted Purchase of Benefit Rights for Inactive Vested Members.** The cost savings for this item is 42 basis points. The Board has previously approved this item. This item would not immediately show up in actuarial reports.

17. **Refund Contributions after Five Years of Inactivity.** The cost savings for this item is 24 basis points.

18. **Tier 2 Low Cost.** The cost savings for this item is 60 basis points. This would apply to future members of ATRS. The plan would require 30 years of service credit for full voluntary retirement, no stipend would be provided, the cost of living adjustment would be set by the Board with a range of 0% to 2.5%, and the noncontributory multiplier would be set at .7%.

19. **Tier 2 High Cost.** The cost savings for this item is 107 basis points. This would apply to future members of ATRS. The plan would require 35 years of service credit requirement for full voluntary retirement, vesting at 10 years of service, age based retirement would increase from 60 to 65, no stipend, 0% to 2.5% cost of living adjustment to be set by the Board, 10 years of service credit requirement for survivor or disability retirement, a six month separation period for all retirees, regardless of service credit or age, no death benefit, and a noncontributory multiplier of .7%.

Mr. Lester *moved* to *approve* directing ATRS staff to draft legislation on all proposed legislation items as need to take action in the future. Mr.

Black *seconded* the *motion*, and the Board *unanimously approved the motion.*

F. **Open Forum for Potential Rule or Law Changes by Committee Members and Board Members in Attendance.** This item has been placed on the Operations Committee agenda to ensure that Trustees have a quality forum to suggest rule changes, law changes, actuarial studies, and other issues that would be appropriate to address as part of improving ATRS operations and benefit structure

XIV. **Staff Reports.**

A. **Medical Committee Reports.** Mr. Ray presented the Medical Committee report for November 2012. In November 2012, there were 14 applicants, 12 were approved, and two were denied.

Ms. Nichols *moved approve* the November 2012, Medical Committee report. Mr. Black *seconded* the *motion*, and the Board *unanimously approved the motion*

B. **Quarterly Travel Update for Board, Staff, Preretirement Counselors.** Ms. Ferguson presented the quarterly travel update on Board, ATRS staff, and preretirement counselor travel. Total Board travel expenses are down 10.51% from 2011. Total ATRS staff and preretirement counselor travel is up 13.9% from 2011.

XV. **Other Business.**

XVI. **Adjourn.**

Ms. Nichols *moved to adjourn* the Board of Trustees Meeting. Ms. Riddle *seconded* the *motion*, and the Board *unanimously approved the motion.*

Meeting adjourned at 2:45 p.m.

George Hopkins, Executive Director	Dr. Richard Abernathy, Chair Board of Trustees
Amy Glavin, Recorder	Date Approved