

**MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING**

**Thursday, November 15, 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
Dr. Tom Kimbrell
Danny Knight
Bobby Lester
Donna Morey
Robin Nichols
Janelle Riddle*
Brent Taylor, designee for Candace Franks

Guests Present

Sarah Ganahl, Bureau of Leg. Research
Beverly Leming, Former Trustee
Aaryn McCosh, Div. of Legislative Audit
Steve Singleton, ARTA

ATRS Staff Present

George Hopkins, Executive Director
Gail Bolden, Deputy Director
Chris Ausbrooks, Senior Software Support
Kay Daniel, Director's Assistant
Mitzi Ferguson, Chief Fiscal Officer
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
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Internal Audit/Risk Mgmt

Consultants Present

Michael Bacine, Franklin Park

**via teleconference*

- 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. Honorable Charlie Daniels was absent.
- II. **Motion to Excuse Absences.**
- III. **Adoption of Agenda.**

Ms. Coleman moved for adoption of the Agenda. Ms. Nichols 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. **Approval of Board Minutes.**

A. **Minutes of August 6, 2012.**

Ms. Morey moved to approve the Minutes of the Board of Trustees meeting of August 6, 2012. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

B. **Minutes of October 29, 2012.**

Ms. Nichols moved to approve the Minutes of the Board of Trustees meeting of October 29, 2012. Mr. Knight seconded the motion, and the Board unanimously approved the motion.

VI. **Member Appeal.**

A. **Billy Whitmire Administrative Appeal.** Ms. Gilson presented the administrative appeal for member Billy Whitmire to the Board regarding recalculation of his disability benefits. Neither Mr. Whitmire nor his counsel were present for the appeal. The Hearing Officer provided a proposed decision for the Board. The Board may affirm the decision of the Hearing Officer, reject the decision of the Hearing Officer and impose its own decision, modify the order, make its own findings, or remand the matter back to the Hearing Officer for additional consideration of matters the Board deems appropriate.

Mr. Knight moved to affirm the Hearing Officer's decision in the matter of Billy Whitmire's administrative appeal. Mr. Lester seconded the motion, and the Board unanimously approved the motion.

VII. **2013 Board of Trustees Election Update & Schedule.** Mr. Hopkins presented the notice for the 2013 Board of Trustees elections. There are four positions up for reelection in 2013: Position #1, 1st Congressional District, Position #3, 3rd Congressional District, Position #4, 4th Congressional District, and Position #10, Retiree Trustee.

VIII. **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.

IX. **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. Subsequently, ATRS waived \$3600.00 in interest and penalties due to employers converted to the EFT process.

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

A. **Arkansas Real Estate and Alternative Investments Update.**

1. **Woodland Heights Update.** The staff at Woodland Heights is more interactive with residents and the activities menu has expanded, which contributes to overall resident satisfaction. Since Woodland Heights is an independent living facility, failing health and death affects the occupancy rate, which remains at 72%.
2. **Victory Building Update.** Occupancy remains at 98%. A new lease was signed November 14 to fill a space an old tenant was vacating. BHP, formerly Chesapeake, is exiting, which will lower occupancy to 95%, but staff is confident that the opening will be filled soon. The parking deck retrofit began November 1 and is going well. ATRS staff is confident that ATRS will recoup the investment very soon.

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

1. **Preliminary Portfolio Performance Update for the Quarter Ended September 30, 2012.** The U.S. market is up 6.2% for the quarter. The non U.S. markets also performed well, up 7.4%. The bond market showed healthy returns, with credit up 3.5% and high yield bonds up 4.5%. However, after September 30, 2012, the U.S. market went down 4% and global went down 2%.

The total fund was up 4.2% for the quarter ended September 30, 2012, slightly underperforming the benchmark of 4.5%. U.S. equity, private equity, and real estate were detractors to performance, all

underperforming their benchmarks. Fixed income was up 3.2%, outperforming the benchmark of 2.0%. ICC Capital was the main detractor for U.S. equity as it is a sizable portfolio and was 5.9% for the quarter, underperforming the benchmark of 6.2%. ICC is also down for the year to date and fiscal year to date benchmarks. Wellington Opportunistic was the main detractor for global equity at 6.5% for the quarter, underperforming the benchmark of 6.8%. Fixed income outperformed the benchmark across the board. The alternative portfolio performed well, with Anchorage and York outperforming their benchmarks. HEK will continue to monitor underperforming managers.

2. **UBS Recommendation.** ATRS first invested in UBS in January of 2008. Since inception, the portfolio has returned 2.2% annually, compared to the 0.0% benchmark. While the portfolio has outperformed its benchmark, recent manager changes have caused some concern. UBS' Head of Global Equities and co-manager of the ATRS portfolio, Nick Melhuish, left the firm. Nicholas Irish has assumed his responsibilities. After considerable time analyzing the impact of the manager change on the portfolio, HEK does not have the confidence in Mr. Irish that they did in Mr. Melhuish and has concerns about their current investment strategies. HEK and ATRS staff recommended that ATRS terminate UBS and transfer the assets into another global equity index fund.

- a. **Resolution 2012-32.**

Ms. Nichols moved to adopt Resolution 2012-32, approving the termination of UBS Global Asset Management. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

3. **BlackRock Institutional Trust Company, N.A. and Recommendation to Hire as an Additional Transition Manager Using imminent Need.** Given the portfolio's size, a transition manager is needed to oversee the liquidation of the UBS account and the reallocation of assets to the global equity index fund. In accordance with Resolution 2011-38, ATRS staff has authorization from the Board to use transition managers from HEK's approved transition manager list. Due to the impracticality of holding standing contracts with several managers, ATRS only has an agreement with State Street as a transition manager. After considerable analysis, HEK and ATRS staff recommended that the Board hire BlackRock as an additional transition manager due to its attractive proposal of waiving management fees for the entire index for two months.

- a. **Resolution 2012-33.**

Ms. Nichols moved to adopt Resolution 2012-33, approving the hiring BlackRock Institutional Trust Company, N.A., as an additional transition manager using imminent need. Mr. Knight seconded the motion, and the Board unanimously adopted the resolution.

C. Real Estate Investment Consultant Update – Hewitt EnnisKnupp.

1. **Preliminary Portfolio Performance Update for the Quarter Ended June 30, 2012.** Net IRR was at 6.5% for the quarter, showing no advancement from the previous quarter. Closed-end funds generally outperformed the NCREIF property index. Net unfunded commitments decreased by \$4.8 million during the quarter. Core funds continued to be positive during the quarter.
2. **ATRS LLC for Deposits, Earnest Money, and Place Holding Investments to Focus on Arkansas Related and Special Opportunity Settings for Initial Action to Preserve Investment Opportunities.** ATRS has established several LLCs to hold ATRS investments. Occasionally, a special investment opportunity may arise in which ATRS must place a deposit, earnest money, place holder money, or initial participation money to preserve or have an opportunity to make an investment. HEK and ATRS staff are proposing a commitment to Pinnacle Mountain Holding Company II LLC for this purpose. It is unlikely to be used extensively but it does provide flexibility as special opportunities arise from time to time. The availability of the commitment will ensure that ATRS can quickly move to evaluate or participate in an investment and do so in a means that has proper controls and reporting to the Board on any activity.

The Investment Committee recommended a commitment of \$2 million to Pinnacle Mountain Holding Company II LLC. The commitment will not be funded unless there is an investment opportunity where a deposit, earnest money, place holder money, or seed money is needed

a. Resolution 2012-38.

Ms. Nichols moved to adopt Resolution 2012-38, committing \$2 million to Pinnacle Mountain Holding Company II LLC for the for the purpose of placing earnest money, deposits, seed capital, place holding money, and participation funds in special opportunity investments. Mr. Knight 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 20, 2012.**
The net IRR for the aggregate portfolio since inception was 8.8%, with a committed capital of approximately \$2.8 billion. The percent change in portfolio value for the quarter was 2.4%.
2. **2013 Private Equity Pacing.** In 2012, ATRS committed \$220 million to seven private equity funds and vehicles. Franklin Park and ATRS staff recommend that ATRS annually commit approximately \$190 million in order to maintain 10% private equity allocation.

Ms. Nichols moved to approve the Franklin Park 2013 Private Equity pacing schedule. Ms. Morey seconded the motion, and the Board unanimously approved the motion.

3. **Recommendation to Commit up to \$20 Million to Franklin Park Venture Fund 2013.** This is a yearly commitment by ATRS. Franklin Park and ATRS staff recommend up to a \$20 million commitment to the Franklin Park Venture Fund 2013.
 - a. **Resolution 2012-34.**

Ms. Nichols moved to adopt Resolution 2012-34, approving a commitment of up to \$20 million to Franklin Park Venture Fund 2013. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

4. **Recommendation to Commit up to \$20 Million to Franklin Park International Fund 2013.** This is a yearly commitment by ATRS. Franklin Park and ATRS staff recommend up to a \$20 million commitment to the Franklin Park International Fund 2013.
 - a. **Resolution 2012-35.**

Ms. Nichols moved to adopt Resolution 2012-35, approving a commitment of up to \$20 million to Franklin Park International Fund 2013. Mr. Knight seconded the motion, and the Board unanimously adopted the resolution.

5. **Recommendation for Additional Commitment to Franklin Park Co-Investment Fund.** Franklin Park and ATRS staff recommend a continuation of the co-investment strategy initiated in 2012 and consider

committing an additional \$20 million to the existing Franklin Park Co-Investment Fund.

a. **Resolution 2012-36.**

Ms. Nichols moved to adopt Resolution 2012-36, approving a commitment of up to an additional \$20 million to Franklin Park Co-Investment Fund. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

XI. **Operations Committee Report.**

A. **Approval of Rules After Public Comment Period.**

1. **Policy 11-1 Survivor Benefits.** ATRS staff reviewed ATRS rules and regulations and found an inconsistency in the definition of "dependent child" with Arkansas law. In order to make ATRS rules more consistent with Arkansas law, ATRS staff recommended changing the definition of "dependent child" to "either a natural child of the member or a child who has been made a child of the member by applicable court action before the death of the member". This rule change has already been approved by the Board and has gone through the 30 day public comment period without comment. The Board must approve the rule again to send it through to the Legislative Review Committee.

Mr. Lester moved to approve Policy 11-1 Survivor Benefits. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

B. **Potential Rule Changes.**

1. **Policy 9-7 Annuity Options and Disposition of Residue After Retirement.** . ATRS staff reviewed ATRS rules and regulations and found that the disbursement of the final retirement check after the death of a member required clarification to prevent future disputes. The proposed rule change states that if the final retirement check is returned or cannot be delivered, ATRS will keep the payment in trust.

Mr. Lester moved to authorize staff to draft a new rule change to Policy 9-7, stating that if a final retirement check cannot be delivered or is returned to ATRS, that ATRS will send the final retirement check to first the residual beneficiary, death beneficiary, or if none, then second to the lump sum death beneficiary; or if none, then to the

member's estate. Ms. Coleman *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.

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

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. These colleges are 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.

D. Approved Law Changes to be Revisited.

- 1. Inactive Members with Only Noncontributory Service to Lose One (1) Noncontributory Year for Each Year the Member is Inactive.** The Board showed reluctance to approve this law change in previous meetings. When GRS studied this change in depth, they discovered that it would only save ATRS one (1) basis point. It was previously approved despite reluctance, but ATRS staff recommended withdrawal of this law

change due to the cost savings not being worth the administrative difficulty and unfairness to inactive members.

Mr. Lester moved to withdraw the proposal to draft a law change that inactive members with only noncontributory service lose one noncontributory year for each year the member is inactive. Ms. Coleman seconded the motion, and the Board unanimously approved the motion

2. **Extend Emergency Rule Making to 180 Days.** This rule change was proposed to make the rule making process more efficient for ATRS, but due to legislative opposition and the appearance of favoritism, ATRS staff recommended withdrawal of this law change.

Mr. Lester moved to withdraw the proposal draft a law change to extend emergency rule making to 180 days. Mr. Goodner seconded the motion, and the Board unanimously approved the motion

3. **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.

Mr. Lester moved to authorize staff to draft legislation allowing a member to voluntarily delete service on years on which employee contributions are owed. Mr. Stubblefield seconded the motion, and the Board unanimously approved the motion

- E. **Proposed Law Changes.** ATRS needs an extra \$80 million a year to return to a 30 year amortization period. There are limited ways to raise the needed \$80 million: increase revenues, decrease current payouts, and slow the accrual of future benefits.

1. **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.** The ATRS staff is proposing 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.

Mr. Lester moved to authorize ATRS staff to draft legislation regarding contract buy out, settlement agreements, court ordered payments, contracts won through litigation, judgment, or decree. Ms. Coleman seconded the motion, and the Board unanimously approved the motion

2. **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.

Mr. Lester moved to authorize ATRS staff to draft legislation giving the ATRS Board rule making authority regarding IRS matters. Ms. Coleman seconded the motion, and the Board unanimously approved the motion

F. Anticipated Actuarial Needs and Suggestions Research by Staff in Preparation for the 2013 Session.

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. **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.
3. **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.
4. **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.
5. **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.
6. **Eliminate \$75 Stipend Flash Cut.** The cost savings for this item is 151 basis points.
7. **Reduce Stipend to \$50.** The cost savings for this item is 47 basis points.
8. **Eliminate \$75 Stipend over Three Years.** The cost savings for this item is 139 basis points.

9. **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.
10. **Increase Member Contribution Rate by 1%.** The cost savings for this item is 70 basis points.
11. **Increase Member Contribution Rate by 2%.** The cost savings for this item is 140 basis points.
12. **Change Contributory Multiplier for Future Service to 2.10%.** The cost savings for this item is 24 basis points.
13. **Change Noncontributory Multiplier for Future Service to .75%.** The cost savings for this item is 75 basis points.
14. **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.
15. **10 Year Vesting.** The cost savings for this item is 16 basis points. This item presents potential problems with recruitment and reciprocal service credit with other retirement systems.
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%.

G. 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.

XII. Staff Reports.

A. Medical Committee Reports. Mr. Ray presented the Medical Committee reports for August 2012, September 2012, October 17, 2012, and October 23, 2012. In August 2012, there were five applicants and all five were approved. In September 2012, there were 21 applicants, 13 were approved, and eight were denied. On October 17, 2012, there were 23 applicants, 22 were approved, and one was denied. On October 23, 2012, there was one applicant and it was approved.

Ms. Coleman *moved approve* the August 2012, September 2012, October 17, 2012, and October 23, 2012, Medical Committee reports. Ms. Nichols *seconded the motion*, and the Board *unanimously approved the motion*

B. Financial Reports. Ms. Ferguson presented the financial comparison of the 2011 and 2012 fiscal year. The change in cash balance was due to the new electronic funds transfer (EFT) system for reporting accounts. Accounts receivable dropped significantly due to EFT. Employee contributions are down from 2011 due to fact that purchase accounts were booked for the first time in 2011. The auditors have requested that this report become a quarterly report, to which Ms. Ferguson will comply.

XIII. Executive Session to Discuss Executive Director's Performance Evaluation. Chair, Dr. Abernathy, called the Executive Session of the Board of Trustees to order at 1:53 p.m.

Chair, Dr. Abernathy, reconvened the Board of Trustees meeting at 2:07 p.m.

Mr. Knight *moved to extend* Mr. Hopkins' employment with the maximum benefits allowed the executive director position by law. Ms. Morey *seconded the motion*, and the Board *unanimously approved the motion*.

XIV. **Other Business.**

A. **Recognition of Beverly Leming's Service to the Board.**

a. **Resolution 2012-37.**

Mr. Lester *moved to adopt* Resolution 2012-37, in recognition of Beverly Leming's service to the ATRS Board of Trustees from July 1, 2005, to June 30, 2012. Ms. Clayton *seconded the motion*, and the Board *unanimously adopted the resolution*

XV. **Adjourn.**

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

Meeting adjourned at 2:14 p.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Amy Glavin,
Recorder

Date Approved