MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES – CALLED MEETING

Monday, November 13, 2017
10:30 a.m.
1400 West Third Street
Little Rock, AR 72201

ATTENDEES

Board Members Present
Jeff Stubblefield, Chair
Danny Knight, Vice Chair
Dr. Richard Abernathy*
Anita Bell
Lloyd Black
Kathy Clayton
Kelly Davis
Danny Knight
Bobby Lester
Robin Nichols
Deborah Thompson
Janet Watson

Board Members Absent
Candace Franks
Johnny Key
Andrea Lea
Dennis Milligan

Reporter Presen
Mike Wickline, AR Democrat Gazette

ATRS Staff Present
George Hopkins, Executive Director*
Gail Bolden, Deputy Director
Curtis Carter, Chief Financial Officer
Laura Gilson, General Counsel
Rod Graves
Rett Hatcher, Deputy Director
Kevin Odum, Attorney Specialist
Tammy Porter, Executive Assistant
Mike Ray, Dir. Member Services
Clint Rhoden, Director of Operations
Joseph Sithong, Software Support Analyst
Leslie Ward, Manager, Private Equity
Brenda West, Internal Audit/Risk Mgmt.

Consultants Present
PJ Kelly, AHIC (Aon Hewitt)

Guest Present
Judy Kermans, GRS
Brian Murphy, GRS
Donna Morey, ARTA
David Kizzia, AEA
Emily Tucker, Div. of Legislative Audit
Gail Stone, APERS
Jay Wills, APERS
Steve Faris, APERS
Rep. Douglas House, Arkansas House of Representatives

I. **Call to Order/Roll Call.** Mr. Stubblefield, Chair, called the Board of Trustees meeting to order at 10:00 a.m. Voice roll call was taken. Ms. Candace Franks, Mr. Johnny Key, Hon. Andrea Lea, and Hon. Dennis Milligan were absent.

II. **Adoption of Agenda.**

Ms. Nichols *moved* for *adoption* of the Agenda. Dr. Abernathy *seconded* the *motion* and the Board *unanimously approved the motion.*

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

IV. Investment Committee Report. *Robin Nichols, Chair*

A. Recommendation to Commit up to an Additional $110 Million Dollars in Aeolus Catastrophe Keystone PF Fund, LP, an Opportunistic/Alternative Reinsurance Fund Specializing in Property Catastrophe Insurance Coverage with Imminent Need. This is the third recommendation on investing with Aeolus, after a recommendation of up to $110 million dollars was approved in 2015 and a recommendation of up to $37 million dollars was approved in 2016. Aeolus Reinsurance, based in Bermuda, was founded in 2006 by Peter Appel and David Eklund. This firm was seeded by large investors, such as Bank of America and Merrill Lynch, and successfully provided global catastrophic protection to the reinsurance market for several years. In 2011 the founders transformed the firm into Aeolus Capital Management in order to raise capital from other third party investors to provide additional flexibility in deploying capital. The fund, Aeolus Property Catastrophe Keystone PF Fund, LP, seeks to use highly customized portfolios based on actuarial projections concerning catastrophic events, such as hurricanes, to provide returns that are not usually correlated to other asset classes. The fund is expected to yield a gross return of the Treasury bill rate plus 15%, or 10-11% net of expected losses and fees. Reinsurance and retrocession markets underwrite in two seasons, January 1st and June 1st.

The Board authorized commitment of up to $110 million dollars in the fund at the October 5, 2015 meeting was for the January underwriting season. The Board authorized commitment of up to $37 million dollars in the fund at the April 4, 2016 meeting was for the June underwriting season. Both Aon Hewitt Investment Consulting and ATRS staff recommend an additional allocation of up to $110 million dollars to Aeolus Property Catastrophe Keystone PF Fund, LP. The expected distribution of the additional allocation is approximately $50 million dollars in the January renewal tranche with the remaining $60 million dollars to be available for larger than normal holdbacks across the prior tranches and to maintain the appropriate ATRS investment allocation to each tranche. Because of hurricanes during the recent underwriting seasons, Aeolus is reserving more funds than usual to deal with any potential claims. The $110 million dollar additional commitment is needed this year for two reasons. The first reason is to take advantage of the current opportunity for increased expected returns. The premiums that create profits for Aeolus are expected to increase from 10% to 30% due to claims created by the recent hurricanes and the additional allocation ($50 million) will be used to take advantage of the upcoming underwriting season that is expected to be well positioned to gain from the increasing premiums. The second reason is the higher than usual level of claims creates a need to reserve additional funds that would normally be released to investors in time for investment in the upcoming January tranche. The additional allocation request ($60 million) is required to deal with the timing issue between reserves for potential claims, and the timing required to fund the upcoming underwriting seasons. Similar to the prior investments in Aeolus, the draft resolution for this additional allocation also allows for recallable distributions.

If approved, ATRS will be entering the January renewal term that runs for a 1 year period. Investment in reinsurance funds will help ATRS to continue to add diversification to the ATRS portfolio and help reduce the reliance on the traditional stock and bond markets. Since the only close for this investment opportunity is expected to take place before the next scheduled meeting of the ALC, Imminent Need is being requested.

Mr. Hopkins confirmed that staff concurs with the recommendation.

1. Resolution 2017-26

Ms. Nichols *moved* to *adopt* Resolution 2017-26, to Commit up to an Additional $110 Million Dollars in Aeolus Catastrophe Keystone PF Fund, LP, an Opportunistic/Alternative Reinsurance Fund Specializing in Property Catastrophe Insurance Coverage with Imminent Need, and the Board *unanimously approved the motion*.

B. Fixed Income Presentation and Recommendation to Adjust the Target Ranges of the Fixed Income and Total Equity Allocations in the Investment Policy Statement. P.J. Kelly of Aon Hewitt Investment Consulting (AHIC) will provide the Board with information concerning the asset allocation mix of fixed income and total equity. The current target allocations as stated in the ATRS Investment Policy Statement (IPS) are 20% for fixed income and 50% for total equity. Recently the ATRS fixed income allocation has been around 15% to 16% of the total portfolio due to strong growth in other areas of the portfolio outpacing the growth of the fixed income portfolio.

AHIC recommends reducing the target allocation to fixed income to be more in line with the historical actual allocation to fixed income. The adjustment of the target ranges to fixed income and total equity should improve the expected rate of return of the ATRS investment portfolio. The ATRS investment portfolio has benefited by investments in other asset classes outside of the fixed income allocation that hold their value in down markets so the recommended fixed income target allocation can be lowered without concern about the fixed income allocation's purpose of being a down market foundation. Both AHIC and ATRS staff recommend updating the IPS to adjust the current allocation targets of fixed income (20%) and global or total equity (50%) by lowering the fixed income target allocation to 15% and increasing the total equity target allocation to 55%.

Mr. Hopkins report that staff concurs with the recommendation.

Ms. Nichols *moved* to *approve* Fixed Income Presentation and Recommendation to Adjust the Target Ranges of the Fixed Income and Total Equity Allocations in the Investment Policy Statement and the Board *unanimously approved the motion*.

VII. **Recess.** The Board recessed at 11:30 a.m. for Lunch. Board meeting reconvened at 12:20 p.m.

VII. **Recommendation to Adopt New Actuarial Assumed Rate of Return.** The actuarial assumed rate of return is the projected rate of investment returns used by actuaries to estimate a pension plan's future growth and asset size. A lower assumed rate of return will result in increasing the long term liabilities of ATRS. The Board periodically reviews the actuarial assumed rate of return used by ATRS to ensure it fairly and accurately reflects a reasonable rate of return for ATRS based upon the ATRS asset allocation, the expected rates of inflation, projected economic conditions, global economic activity, and actuarial standards.

As of June 30, 2017, ATRS had a fiscal year investment return of 16.1% and a since inception investment return of 8.5% that relates back to 1986. The ATRS investment returns over the periods of one year, three years, five years, and since inception rank among the top of all pension plans with over $1 billion dollars in assets. At the same time continued periods of lower inflation and changing actuarial standards have resulted in pension plans generally reducing actuarial assumed rates of return. With input from the ATRS general investment consultant, Aon Hewitt Investment Consulting, Inc. (AHIC), and additional input from Gabriel, Roeder, Smith, & Co. (GRS), ATRS staff recommends adjusting the ATRS actuarial assumed rate of return from 8% to 7.5%. Although ATRS staff believes that with the alpha returns available through its investment profile an 8% rate of return would remain reasonable, the standards used to view potential rates of return focus on beta returns without giving credit to alpha that can be generated in portfolios like ATRS. This recommendation is made even while considering that it will necessitate changes in benefit structure that are difficult to consider implementing.

A. **Resolution 2017-27**

Dr. Abernathy *moved* to *adopt* Resolution 2017-27, to Adopt New Actuarial Assumed Rate of Return. Mr. Knight *seconded the motion*, and the Board *unanimously approved the motion*.

IX. Recommendation to Adopt RP-2014 Mortality Table for the Actuarial Valuation of ATRS. The life expectancy of a plan's members is one of many factors used to calculate a pension plan's cost of benefits and estimate unfunded liabilities. ATRS pays all retirees a lifetime retirement benefit. The longer the life expectancy of members, the larger the total payout will be to the membership group as a whole. The life expectancy of a pension plan's members is estimated using mortality assumptions produced by actuarial groups. These assumptions are called "mortality tables". These mortality tables are generated using national data that sometimes does not translate perfectly to a region or state. Recent studies by actuarial groups suggest that across the broad population of the U.S., life expectancies are increasing. Increasing life expectancies create increasing cost of benefits (additional unfunded liabilities) to a pension plan due to projections that members are living longer and will receive monthly benefits longer than currently anticipated. Actuaries must use mortality tables to gauge the life expectancy of a pension plan's members when forecasting a pension plan's cost of benefits. Assumed increases in life expectancies nationally have generated a new mortality table (RP-2014) that is being widely adopted by pension plans around the U.S. The adoption of mortality table RP-2014 will add material additional unfunded liabilities to ATRS. The Board periodically reviews the mortality table used by ATRS to ensure it is adequately conservative and accurately reflects reasonable life expectancies and is generally accepted by actuaries for plan valuations. With input from the ATRS actuary, GRS, ATRS staff recommends the adoption of the RP-2014 to be used in fiscal year 2018. ATRS staff also recommends the continued use of RP-2014 with an appropriate projection scale for each fiscal year after 2018 until such time as the Board may approve another mortality table in the future.

A. **Resolution 2017-28**

Mr. Lester *moved* to *adopt* Resolution 2017-28, to Adopt RP-2014 Mortality Table for the Actuarial Valuation of ATRS. Ms. Clayton *seconded the motion*, and the Board *unanimously approved the motion*.

X. Recommendation to Adopt Additional Actuarial Assumptions Established by the Experience Study. Judy Kerman's and Brian Murphy from GRS, presented the actuarial assumptions established by the experience study.

A. Resolution 2017-29

Ms. Nichols *moved* to *adopt* Resolution 2017-29, to Adopt Additional Actuarial Assumptions Established by the Experience Study. Mr. Lester *seconded the motion*, and the Board *unanimously approved the motion*.

XI. Recommendation to Adjust Member Contribution Rate Beginning in Fiscal Year 2020. A.C.A. § 24-7-406 authorizes the Board to establish and modify the member contribution rate paid into ATRS by contributory members. The Board can set the member contribution rate between 6% and 7%. Contributory members currently pay 6% of salary to ATRS. The 6% member contribution rate has not been changed in 43 years. Most retirement plans across the country have a materially raised member contribution rates in those 43 years with many member contribution rate increases since the financial crisis in 2008. The ATRS Board undertook alternate methods to maintain financial strength after the financial crisis. However the adoption of a lower assumed rate of return and the RP-2014 mortality table necessitate various changes to maintain financial strength and quality sustainability. ATRS staff recommends a period of pause prior to implementation of a member contribution rate increase and also that the rate increase be phased in over a four year period. This provides contributory members greater flexibility and time to absorb the change. The staff recommendation is to implement a 0.25% per year increase in the member contribution rate beginning in fiscal year 2020 with the final 0.25% increase occurring in fiscal year 2023 to bring the member contribution rate to 7% in fiscal year 2023.

A. Resolution 2017-30

Ms. Thompson *moved* to *adopt* Resolution 2017-30, to Adjust Member Contribution Rate Beginning in Fiscal Year 2020. Mr. Lester *seconded the motion*, and the Board *unanimously approved the motion*.

XII. Recommendation to Adopt New Noncontributory Multiplier Beginning in Fiscal Year 2020. Historically, when ATRS has modified the contributory multiplier, the noncontributory multiplier is adjusted in alignment with the change in the contributory multiplier. The change in the contributory member contribution rate means that contributory members will pay more to maintain the contributory multiplier of 2.15%. In order to maintain alignment and parity with contributory members, the noncontributory multiplier should be reduced in line with the additional cost born by contributory members. Said another way, the increase in the contributory rate by 1% and adjusting the noncontributory multiplier in parity with that increase should have the same effect as increasing the employer contribution rate by 1%. A.C.A. § 24-7-705 allows the Board to adjust the multiplier rate for noncontributory service earned in fiscal years after the change to the noncontributory multiplier rate is adopted. Earned noncontributory multipliers are not subject to change. A.C.A. § 24-7-705 provides the Board may set the multiplier rate for all future noncontributory service between 0.5% and 1.39%. The current multiplier for noncontributory service is 1.39%. ATRS staff recommends that the noncontributory multiplier be reduced to 1.25% beginning in fiscal year 2020. A 1.25% multiplier for noncontributory service brings the noncontributory rate in close parity with the higher contribution rate for contributory service. As a reminder, any noncontributory member may become contributory by filing an election with ATRS before the beginning of a fiscal year and receive the higher contributory multiplier.

A. Resolution 2017-31

Dr. Abernathy *moved* to *adopt* Resolution 2017-31, to Adopt New Noncontributory Multiplier Beginning in Fiscal Year 2020. Ms. Nichols *seconded the motion*, and the Board *unanimously approved the motion*.

XIII. Recommendation to Adopt Initial Multiplier for the Member's First 10 Years of Service Beginning in Fiscal Year 2019. The ATRS Board has expressed continued interest in having lower initial multipliers for both contributory and noncontributory service for members retiring before reaching 10 years of service. The topic has continued to come up and be discussed favorably at ATRS Board meetings. ATRS has tried to provide material incentives for members to work past 10 years of service the incentives include becoming eligible for the lump sum death benefit and receiving the benefit stipend. Several Board members see an additional incentive by establishing lower multipliers for members retiring short of ten years of service with members working beyond ten years of service to have initial service converted to standard multipliers as if the initial multiplier had never been used. This resolution was prepared in response to those discussions to set an initial multiplier for contributory service at 1.75% and an initial multiplier for noncontributory service at 1%. Any member obtaining 10 years of credit service would be totally unaffected by the initial multipliers since the initial multipliers are replaced and backfilled by standard multipliers once 10 years of service is reached. At the same time retirees from other states that "cross the border" and often stay in ATRS just 5 years to receive a secondary retirement benefit would see a reduction that has been discussed at previous ATRS Board meetings. Importantly, to not impact recruiting from other retirement systems in Arkansas, reciprocal service in another state retirement system such as APERS or a public college would count toward the 10 year service requirement to obtain the backfill to the standard multiplier. The resolution as drafted would begin the initial multiplier for fiscal year 2019. Also note that previously earned multipliers before fiscal year 2019 would not be affected by this resolution. All earned multipliers through fiscal year 2018 would not be subject to a reduction or modification. A.C.A. § 24-7-705 authorizes the Board to set an initial multiplier rate for both contributory and noncontributory service for the first ten (10) years of service credit that is lower than the standard multiplier rate. The Board has the ability to set the initial multiplier rate for the first ten years of contributory service from a maximum of 2.15% to not less than 1.75%. The Board also has the ability to set the initial multiplier rate for the first ten years of noncontributory service from a maximum of 1.39% to not less than 0.5%.

A. Resolution 2017-32

Mr. Lester *moved* to *adopt* Resolution 2017-32, to Adopt Initial Multiplier for the Member's First 10 Years of Service Beginning in Fiscal Year 2019. Ms. Davis *seconded the motion*, and the Board *unanimously approved the motion.*

IXV. Recommendation to Adopt Five (5) Year Final Average Salary with a Protective Three (3) Year Permanent Benchmark. ATRS executive staff has been working closely with the actuaries since it became clear that a new mortality table and a reduction in the assumed rate of return were items that ATRS had to consider. Other retirement systems around the country are dealing with the same costly issues. A consistent approach used to contain cost and insure that contributions received on salary are more in line with actual "final average salary" has been to adopt a five year calculation to establish final average salary. A three year final average salary was adopted by ATRS in 1998. Pension plans around the country generally moved to a three year average salary calculation during that era. A three year final average salary invites greater anti-selection opportunities and is more subject to spiking techniques that provide a higher benefit than the contributions received were designed to fund. The use of a five year final average salary makes spiking more difficult to achieve since it adds to the number of years that the spiking technique would be required to cover. The risk of adopting a five year final average salary after using a three year final average salary is members may be encouraged to immediately retire if the member might see a dip in benefits once the five year final average salary becomes effective. No member should be incentivized to retire early due to the adoption of a five year final average salary. The resolution as written guarantees that no active member with three full years of ATRS service will receive a reduction in benefits by continuing to work through the effective date of the conversion to a five year final average salary. In fact, all member benefits will continue to increase if the member works after the conversion. This guaranteed positive outcome is achieved through ATRS providing all eligible members to have a benchmarked three year final average salary using the same formula ATRS would use today if the member were retiring or entering T-DROP on July 1, 2018. ATRS staff will compute this three year final average salary benchmark to be used as a permanent comparison to the five year final average salary calculation with the higher of the two calculations becoming the member's final average salary for the calculation of benefits. A.C.A. §§ 24-7-202 (18) and 24-7-736 authorize the Board to adjust the final average salary calculation. One method to adjust the final average salary calculation is to adjust the number of years used in the calculation of the final average salary between three (3) and five (5) years of service.

A. Resolution 2017-33

Ms. Bell *moved* to *adopt* Resolution 2017-33, to Adopt Five (5) Year Final Average Salary with a Protective Three (3) Year Permanent Benchmark. Ms. Watson *seconded the motion*, and the Board *unanimously approved the motion.*

XV. Recommendation to Adjust Benefit Stipend Amount Beginning in Fiscal Year 2020 with Base Change in Fiscal Year 2019. The benefit stipend was created in 1999 as an ad-hoc supplement to eligible retirees' benefits. About 41,000 of the 45,000 current retirees and beneficiaries receive the benefit stipend. It was initially a $50 per month supplement that was ultimately increased to a $75 per month supplement. The benefit stipend is not a part of a members earned benefit. For unknown historic reasons the benefit stipend was added to the base of all members for the purpose of the simple COLA calculation each year. New retirees in the current fiscal year do not have the benefit stipend as part of the base. As ATRS makes changes to absorb the cost of the lower assumed rate of return and the RP-2014 mortality table, the ATRS staff recommends that retirees participate in addressing the changes by removing the benefit stipend from the base for all current retirees beginning in fiscal year 2019 coupled with the reduction in the benefit stipend from $75 dollars back to the original $50 dollars per month beginning in fiscal year 2020 provided that the reduction would have a hold harmless phase in. To ensure that no retiree would see an actual dollar amount reduction in the monthly benefit payment after the stipend is returned to $50 per month, essentially the annual COLA would backfill the implementation of the stipend reduction over more than one fiscal year for any member with a base monthly benefit of less than $833 dollars. A.C.A. § 24-7-713 allows the Board to adjust the amount of the benefit stipend payable to eligible retirees. A.C.A. § 24-7-713(b) provides the Board the ability to set the amount of the benefit stipend payable to eligible retirees from a maximum $75 per month to not less than $1 per month. A.C.A. § 24-7-713(d) states the Board may remove the benefit stipend from the base amount of current retirees and option beneficiaries. The Board may phase in adjustments to the benefit stipend in order to prevent a retiree from receiving a reduction of benefits at any time.

A. Resolution 2017-34

Ms. Nichols *moved* to *adopt* Resolution 2017-34, to Adjust Benefit Stipend Amount Beginning in Fiscal Year 2020 with Base Change in Fiscal Year 2019. Mr. Black *seconded the motion*, and the Board *unanimously approved the motion.*

XVI. Recommendation to Adopt a Fixed T-DROP Interest Rate with Potential Incentive Increase Beginning in Fiscal Year 2019. Until this fiscal year ATRS used a variable interest rate formula that varied between 2% and 6% based upon returns. This fiscal year ATRS set the one year rate at a fixed 5% since it was clear ATRS was moving toward outstanding returns tempered by the Board's understanding that soon ATRS would implement changes due to the actuarial experience study. Here ATRS balances the need to incentivize members to remain in T-DROP which is actuarially beneficial to ATRS while at the same time having T-DROP participants contribute to the process of absorbing the liabilities brought about by the actuarial assumption changes. The recommendation is for ATRS to adopt a fixed 3% regular T-DROP interest rate with the opportunity in years with outstanding returns (9.5% or higher) for the ATRS Board to provide additional incentive interest on top of the fixed rate. The 3% rate is very competitive. APERS pays a fixed 2.5% without an incentive rate opportunity. ATRS staff believes the 3% rate with incentive opportunity strikes the right balance between encouraging participation and longevity in T-DROP with the need to reduce cost. Currently the actuaries assume the T-DROP interest rate will average 5%, moving to a 3% fixed rate saves approximately $8 million dollars per year. The fixed rate would begin fiscal year 2019 and the 3% fixed rate would be accruing to accounts on June 30, 2019. Act 1049 of 2017 allows the Board to determine the T-DROP plan interest rate based upon a variable rate formula or a fixed interest rated adopted by Board resolution prior to the beginning of a fiscal year and applied to all subsequent fiscal years until modified by the Board. A variable interest rate formula would likely be based upon investment returns and other similar factors. If the Board adopts a variable interest rate formula, the plan interest rate is established prior to the beginning of a fiscal year to which the plan interest rate applies. The Board may adopt a T-DROP participation incentive rate during a fiscal year, in addition to the applicable interest rate, if investment returns and financial conditions justify an incentive rate for the fiscal year.

A. Resolution 2017-35

Ms. Bell *moved* to *adopt* Resolution 2017-35, to Adopt a Fixed T-DROP Interest Rate with Potential Incentive Increase Beginning in Fiscal Year 2019. Mr. Lester *seconded the motion*, and the Board *unanimously approved the motion.*

XVII. Recommendation to Adjust Post 10-Year T-DROP Interest Formula Beginning in Fiscal Year 2019. The Post 10-year interest program has major beneficial impact on ATRS. A material number of members complete 10 years in T-DROP and for personal reasons often decide not to retire but continue working. These members could receive a monthly benefit and could potentially withdraw their entire T-DROP balance accrued over the ten year period. When the monthly benefit payments plus the spread ATRS has between the Post 10-year T-DROP interest and its assumed rate of return, ATRS makes millions of dollars by these members obtaining the Post 10-year T-DROP interest in lieu of retirement. ATRS staff recommends that Post 10-year T-DROP continue to pay the current variable interest rate between 4% and 6% (ATRS is paying 6% in fiscal year 2018) using the existing formula after one minor tweak to the process being the use of a calendar year return as estimated by the general financial consultant instead of an annualized return from March 31. This tweak is intended to allow more time to establish a better estimate that created a concern by the Division of Legislative Audit in the past. The Board may establish a formula to be used in setting the Post 10-year T-DROP plan interest according to A.C.A. § 24-7-1307 and ATRS Rule 10-3.

A. Resolution 2017-36

Ms. Clayton *moved* to *adopt* Resolution 2017-36, to Adjust Post 10-Year T-DROP Interest Formula Beginning in Fiscal Year 2019. Ms. Bell *seconded the motion*, and the Board *unanimously approved the motion.*

XVIII. Recommendation to Adjust T-DROP Annuitization Formula Beginning on March 31, 2018. ATRS has used the actuarial assumed rate of return as the interest rate that ATRS assumes it will make on a T-DROP balance that is converted into a monthly benefit. Once ATRS reduces its assumed rate of return below 8%, all the annuitized T-DROP balances establish new liabilities since the T-DROP benefit was set at 8% while the actuarial assumption is now lower. Said another way, on all T-DROP annuitizations using the 8% rate of return places an 8% return risk on ATRS as long as the member lives. ATRS staff recommends that the T-DROP annuitization factors be changed to better align with private insurance companies offering annuities. This means applying mortality tables in use at the time T-DROP is annuitized to ensure the appropriate life expectancy is included and over time bringing the assumed return on the T-DROP balance to be annuitized more in line with the private annuity industry. This means initially dropping the assumed rate of return for annuitization of T-DROP balances to 7.5% and over several years reducing the assumed rate of return on T-DROP annuitization to 3% or the return on a 10 year treasury instrument, whichever is higher. This slow reduction over time lessens the difference between recent annuitization estimates and the updated calculation while reaching the recommended annuitization interest assumption in a reasonable time. A.C.A. § 24-7-1308 authorizes the Board to determine the annuitization factors for converting T-DROP plan balances to a monthly benefit.

A. Resolution 2017-37

Mr. Knight *moved* to *adopt* Resolution 2017-37, to Adjust T-DROP Annuitization Formula Beginning on March 31, 2018. Ms. Davis *seconded the motion*, and the Board *unanimously approved the motion.*

XIX. Recommendation to Increase CBA Interest Rates. The CBA account for members retiring from T-DROP and leaving a discretionary balance at ATRS for future withdrawal has been a win for members and a win for ATRS. Members win by having a quality fixed income product in a safe environment to protect principal that is competitive with other alternatives that would place the principal at risk. ATRS benefits by receiving the spread between average interest paid on

CBA accounts and actual earnings. For instance, last fiscal year ATRS received over a 13% net return on existing CBA balances (the difference between a 16.1% and an estimated average CBA interest rate of 2.75%). The actuaries have indicated that since the CBA program is now well established and the funding is consistent, that ATRS may receive credit on the spread between the highest CBA interest rate and the assumed rate of return. (7.5% minus 4% equals 3.5%) This means that as ATRS continues to gain traction in CBA balances, ATRS has actuarial gains projected into its assets. For instances, if CBA balances reach $200 million dollars, the annual actuarial gain would be $7 million dollars. That is material when considering that it is approximately a 1/4% employer contribution rate increase. While ATRS staff recommends de-risking annuitization of T-DROP, staff recommends that CBA interest rates for initiation and early years in CBA have increased interest rates due to meeting market conditions and to stimulate growth in the aggregate CBA balances. The recommendation is the initial CBA rate be increased from 2% to 2.5% beginning on July 1, 2018, with the second year through fifth year interest rates being increased 0.5% and reaching the 4% interest rate in year six (6) rather than the current 4% interest rate in year eight (8). Staff believes these enhanced interest rates will encourage greater CBA participation at the time of retirement from T-DROP and lengthen the time CBA balances are left at ATRS.

The Board has authority to adjust CBA rates to adapt to market conditions so long as it does not reduce the CBA interest rate schedule that members were provided at the time entry into the CBA program is made. Since all the interest rate changes are positive to the CBA participants, the rule allows the Board to adjust the CBA interest rates by Resolution.

A. Resolution 2017-38

Dr. Abernathy *moved* to *adopt* Resolution 2017-38, to Increase CBA Interest Rates. Ms. Nichols *seconded the motion*, and the Board *unanimously approved the motion.*

XX. Recommendation to Adjust Beneficiary Option Formulas. The Board has authority to make modifications to the beneficiary annuity option factors. An essential change is to adopt the new mortality table as part of the formula to establish the reduction required to provide an option benefit to another person. Option A and Option B benefits are payable only to an eligible spouse and Option C a 120 payment guarantee is payable to anyone. In establishing the reduction, the actuarial factors such as the mortality table impact the amount of the reduction to provide the option benefit. An unanticipated outcome of the longer assumed lifetimes of members caused by RP-2014, is that without adjusting the assumed rate of return below 7.5% may in several instances create a smaller reduction than the existing option beneficiary formula. To ensure option beneficiaries do not create additional liabilities to be borne by ATRS member, and to ensure that option beneficiaries contribute to the process of reducing costs, staff recommends that in addition to adopting mortality table RP-2014, that the assumed rate of return for establishing the option beneficiary reduction be 5%. This creates a slightly higher reduction than the reduction that would be created today by about 3% in most instances. This seems to be a fair reduction when considering the contribution other members are making to address the actuarial changes.

A. Resolution 2017-39

Mr. Lester *moved* to *adopt* Resolution 2017-39, to Adjust Beneficiary Option Formulas. Ms. Bell *seconded the motion*, and the Board *unanimously approved the motion.*

XXI. Recommendation to Adjust Employer Contribution Rate Beginning in Fiscal Year 2020. A.C.A. § 24-7-401(c) allows the Board to establish the employer contribution rate to be paid to ATRS. Changing the contribution rate requires that ATRS be over an 18 year amortization and that member groups through cost reductions and contribution increases provide actuarial savings that are at least equal to, or exceed, the amount generated by an increase in the employer contribution rate. The law also requires that ATRS is limited to a 1% employer increase (capped at 15%) that has to be phased in at a 1/4% per fiscal year. The last time ATRS had an employer increase was over 12 years ago. If the Board adopts the resolutions prior to this resolution in substantially the form in which the resolutions were presented, the net savings materially exceeds the amount generated by the phased in 1% increase provided for in this resolution. Importantly, the first employer increase would not happen until fiscal year 2020, with 1/4% increases per year through fiscal year 2023. This gives ample time for employers to prepare for the increase and for any process for the payment of the increase to be tweaked to the extent necessary for an orderly transition period from 14% to 15% for the employer contribution rate. Absent this employer contribution rate increase, the impact to the members would be greater. Staff recommends the adoption of this resolution to maintain actuarial soundness.

In conclusion, if the resolutions in this actuarial package today are adopted in substantially the form presented, ATRS will be right at a 30 year amortization. On the other hand, if ATRS adopts the 7.5% rate of return, RP-2014, and the other updated assumptions from the experience study without adopting benefit and contribution changes, the ATRS amortization period would exceed 100 years. This entire resolution package brings ATRS back to a reasonable amortization period using a very conservative mortality table, using a conservative assumed rate of return that has no alpha return consideration, and that shares the burden of maintaining soundness and sustainability without the material benefit changes that other retirement systems around the country have experienced or are facing.

A. Resolution 2017-40

Mr. Black *moved* to *adopt* Resolution 2017-40, to Adjust Employer Contribution Rate Beginning in Fiscal Year 2020. Mr. Knight *seconded the motion*, and the Board *unanimously approved the motion.*

XXII. Other Business. None

XXIII. Adjourn.

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

Meeting adjourned at 1:46 p.m.

George Hopkins,
Executive Director

Jeff Stubblefield, Chair
Board of Trustees

Tammy Porter, Recorder

Date