

**Regular Meeting
Board of Trustees**

February 12, 2002

The Board of Trustees of the Arkansas Teacher Retirement System convened on Tuesday, February 12, 2002, at 9:00 a.m. The meeting was held in the ATRS Board Room, 1400 West Third, LittleRock, Arkansas.

Members of the Board Present:

Linda Parsons, Chair
Charles Vondran, Vice Chair
Winfred Clardy
Hazel Coleman
Charles Dyer
Dr. Paul Fair
John Fortenberry
Ann Harbison
Mary Harris
Betty McGuire
Louis Midkiff
Frank White
Gus Wingfield

Members of the Board Absent:

Jimmie Lou Fisher
Ray Simon

Staff Present:

Bill Shirron, Executive Director
George Snyder, Chief Fiscal Officer
Gail Blair, Manager, Data Processing
Dena Dixson, Manager, Membership & Payroll
Tammy Medlock, Administrative Assistant
Marla Palmer, Investment Specialist
Michael Ray, Manager, Benefits & Counseling
Hugh Roberts, Retirement Fund Investment Supervisor
Barbara Waldrop, Manager, Preretirement Education
Dale Walker, Investment Specialist

Others Present:

Randy Abner, Optdata, Inc.
Andy Aldridge, Retiree
Darrell Dover, Dover Dixon Horne, PLLC
Tom Ferstl, Ferstl Enterprises
Lloyd Garrison, CDI Contractors
Lynda Hogue, Retiree
Ernest Huff, Retiree
Richard Hutchinson, Arkansas Education Association
Hank Kelley, Flake & Kelley Management
Judith Kermans, Gabriel Roeder Smith & Company

Charles Knox, Arkansas Association of Educational Administrators
Don Lewis, Optdata, Inc.
Shirley Matheny, Retiree
James McGuire, Guest of Betty McGuire
Jan Meyer, Flake & Kelley Management
Rob Moritz, Arkansas News Bureau
Brian Murphy, Gabriel Roeder Smith & Company
Don Roberts, Arkansas Retired Teachers Association
Carol Stapleton, Legislative Council
Charles Trammell, Retirement Communities of America
Leonard Venable, Office of the State Treasurer
Mike Wickline, AR Democrat-Gazette

VIII. Roll Call

The minutes were recorded by Tammy Medlock of the Teacher Retirement staff.

IX. Adoption of Agenda

Mrs. Coleman made a motion to adopt the agenda as presented. The motion carried.

X. Next Regular Meeting Date(s)

The next regular meeting of the Board is scheduled for April 8-9, 2002.

XI. Public Comments on Agenda Items

XII. Actuarial Valuation – Brian Murphy, Judith Kermans, Gabriel Roeder Smith & Co.

A. Attorney General's Opinion

Mr. Shirron reported he had not yet received an opinion from the Attorney General regarding the Board's authority to change the employer contribution rate without the consent of the legislature.

B. T-DROP Study Update

Mr. Shirron reported four proposals were received in response to the Request for Proposal to conduct a study of the T-DROP program.

Mrs. Harbison made a motion to let the T-DROP Study Committee (Shirron, Parsons and Dr. Roberts) decide between the Segal and Mercer proposals. The motion did not carry.

Dr. Fair made a motion to let the T-DROP Study Committee examine all materials, negotiate to their satisfaction and take action to have the study conducted. The motion carried.

XIII. Investment Committee Report - Charles Vondran, Chair

The next meeting of the Investment Committee has been rescheduled for 9:00 a.m., Friday, March 22, 2002.

XIV. Real Estate Committee Report – Tom Ferstl, ATRS Real Estate Manager

Mr. Ferstl presented his report (*Attachment C*). The Investment Committee will make the final decision on Mr. Ferstl's recommendations (page 2 of report). The next meeting of the Real Estate Committee is scheduled for 3:30 p.m., Tuesday, February 19, 2002.

XV. Retirement Village Update – Charles Trammell, Retirement Communities of America, Hank Kelley, Flake & Kelley Management

Mr. Fortenberry made a motion that due to the escalation of the cost of construction of the Retirement Village that the Executive Director order work on the project stopped immediately upon completion of site work while a study and evaluation is made to determine if the Project should go forward or be terminated. The motion carried.

XVI. Policies Committee Report – Dr. Paul Fair, Chair

Mr. Clardy made a motion to approve the Governance Process policies as presented on pages 47-62 of the brochure and the Real Estate Committee Charter and Board-Executive Director Relationship – Employment of Executive Director policies revised February 10, 2002 (*Attachment D*). The motion carried.

XVII. Teacher Retirement System Reports

A. Medical Board Summary Report – Michael Ray

Mr. Midkiff made a motion to approve the Medical Board reports as presented. The motion carried.

B. Personnel Report – Bill Shirron

Mr. Shirron reported Dr. Angelo Coppola had submitted his resignation effective March 15, 2002. Mr. Midkiff made a motion to adopt the report as amended. The motion did not carry.

Mr. Midkiff made a motion to adopt the personnel report as presented on page 70 of the brochure. The motion carried.

C. Membership & Payroll

D. Arkansas Related Investments

E. Investment Summaries

F. Financial Statements

G. AASIS Invoice Update – Gail Blair

Ms. Blair reported ATRS is no longer being billed by AASIS.

XVIII. New Business

A. Investment Committee Appointment

Ms. Parsons appointed Winfred Clardy to serve a four-year term.

B. Legislative Committee Appointments

Ms. Parsons appointed the following board members to the Legislative Committee: Clardy, Dyer, Harbison, Vondran and Parsons.

C. ATRS Budget for 2002-2003

Mr. Shirron stated in the future he would provide the names, positions and salaries of all ATRS staff members in the personnel report presented at the regular board meeting each August.

D. ATRS 6-30-2000 Audit Results

Mr. Shirron stated he would notify Board members of any new audit findings when he is made aware of them, and include a plan of correction.

E. Holman Management Contract (Item withdrawn – Audit Not Completed)

XIX. Executive Director's Comments

- Victory Building, Riley Properties Updates – Mr. Shirron reported the Victory Building is 55% leased and is 95% completed. Mr. Ferstl is working toward selling the Riley properties.

XX. Executive Session

No action was taken by the Board.

In other business:

By common consent the Board agreed that Mr. Andy Aldridge should write a letter to Mr. Shirron explaining his issue with insurance.

As there was no further business to consider, Mrs. Coleman a motion to adjourn. The motion carried and the meeting adjourned at 3:45 p.m.

Linda Parsons

Linda Parsons, Chair

Bill A Shirron

Bill Shirron, Secretary to the Board

3-7-02
Date

Arkansas Teacher Retirement System Proposed Work Plan

As of 02/02/02

Meeting Dates ----->	2002 11-Feb	Mar	8-Apr	May	9-Jun	Jul	12-Aug	Sep	14-Oct	Nov	9-Dec	Jan	2003 11-Feb
Annual Seminar Prep for Annual Seminar													
Quarterly Performance Rpts "Flash" Performance Rpts	12/31/01		3/31/02		3/31/02		6/30/02		9/30/02		9/30/02		
Initial Plan Review	X												
Asset & Liability Study Assumption Review First Report Final Report													
Plan Structure Review Individual Asset Class Reviews U.S. Equity Review Fixed Income Review Non-U.S. Equity Review Alternatives & Real Estate Revise Investment Policy													
Mgr Search - International Mandate Approved Candidates Presented Selection Interviews													
Mgr Search - Fixed "Core" Mandate Approved Candidates Presented Selection Interviews													

MEMORANDUM

11 February 2002

To: Board and Staff
Arkansas Teacher Retirement System
From: David Russell, CFA
Stephen Cummings, CFA
Patrick Kelly, CFA
RE: Proposed Manager Selection Process and Recommended Mandates

We believe that your historic and our proposed manager selection process is very similar. It is a process that we believe results in a higher probability of hiring superior managers. Our manager search process is:

Establish the Mandate: EnnisKnupp, in consultation with staff, would develop a proposed mandate for the manager and present the proposed mandate to the Investment Committee for approval. The mandate would include the identification of specific portfolio characteristics, guidelines and risk controls for the manager. The mandate would also establish quality and quantitative selection screens that match the desired mandate. The screens would include factors such as:

- Appropriate registration and regulatory compliance,
- Longevity, depth, and quality of the management team,
- The existence of current portfolios, or specific product offerings, that meets the desired mandate,
- Minimum levels of assets under similar mandates,
- Positive performance characteristics over various time frames relative to appropriate benchmarks,
- The existence of appropriate compliance and risk controls,
- Good communications and client service,
- Competitive fees.

Identify Candidates: EnnisKnupp, working with staff, would use the approved mandate and screens and examine our databases to identify those firms that meet the established criteria and have the best potential fit with the investment program. Our evaluation process would also include any potential candidates recommended by Trustees or Staff. Working with staff, we would narrow down the list of candidates to the top 5 to 8 candidates for presentation to the Board.

Search Report: EnnisKnupp would prepare detailed background information and competitive information regarding the qualifications of the top 5 to 8 candidate firms and present the information to the Investment Committee.

Select Finalists: The Investment Committee would then select from the list of candidates 2 or 3 firms as “finalists” to be interviewed.

The following sections focus on our recommended mandates for fixed income and non-U.S. equity managers.

Recommended Fixed Income Mandate – “Core Plus”

Mandate: The “Core Plus” mandate is characterized by two elements: The “Core” element is comprised of the broad market of investment grade. The “Plus” element is characterized by fixed income securities that are not included in the Lehman Aggregate such as high yield bonds, non-U.S. issuers, and emerging market debt.

Benchmark: This mandate would use the Lehman Aggregate as the benchmark. This benchmark communicates to the manager that their normal or neutral position should be investment grade securities, but the “Plus” would indicate that they may use non-index sectors on a tactical basis when they appear to have positive risk/reward characteristics.

Duration: This mandate would have a range of +/- 1.25 years (a range of about +/- 30%) around the current Lehman Aggregate duration, which is currently about 4.5 years.

Risk Controls: Additional risk controls would include:

- Permitted securities types would include mortgage-backed securities, asset-backed and collateralized securities, commercial mortgage-backed securities, and Section 144A private placements, Yankee bonds and non-dollar bonds of foreign issuers, and below-investment grade (high yield) bonds.
- Individual issues should not exceed 2% of the portfolio (except for U.S. Government and Agency issues)
- The par value of holdings should be at least \$250 million to assure liquidity.
- The manager should not hold more than 50% of an outstanding issue.
- Non-U.S. issuers should be rated “A” or better and should not exceed 20% of the portfolio.
- Non-U.S. dollar denominated securities should be hedged as a normal position, but individual issues may be up to a maximum of 50% unhedged.
- High Yield (below investment grade) securities should not exceed 20% of the portfolio and should not be rated below B- or B3

- Investment structures that exhibit high price volatility, where the price change is a multiple of the underlying asset or index are prohibited. Examples are interest-only strips, principal strips, inverse floaters, super floaters, and jump Z bonds.
- Futures, forwards, options, and swaps would be permitted for purposes of controlling duration, hedging currency exposures and sector allocation management. These instruments would not be permitted where they would create leverage, where there is no underlying assets, or for cross-hedging currency positions.
- Ratings from rating agencies are not to be taken for granted. Intensive and frequent financial analysis should be performed on all investments.

Screens: Candidates will be screened for factors that indicate competence and success, including:

- Appropriate registration and regulatory compliance,
- Longevity, depth, and quality of the management team,
- The existence of current portfolios, or specific product offerings, that meets the desired mandate,
- Minimum levels of \$1 billion in assets under similar mandates,
- Positive performance characteristics over various time frames that demonstrate favorable outcomes relative to the Lehman Aggregate on a risk-adjusted, net of fees basis.
- The existence of appropriate compliance, risk controls, and portfolio monitoring,
- Good communications and client service,
- Competitive fees.

Recommended International Mandate – “ACWXUSI” (All Country World Ex-U.S. Index)

Mandate and Benchmark: The Morgan Stanley Capital International All Country World Ex-U.S. Index (ACWXUSI) Index is comprised of market weight of the 22 “developed” non-U.S. countries, plus Canada, Mexico, and approximately 23 other “emerging market” countries. The ACWXUSI benchmark as of 12/31/01 has approximately a 9% market weight to countries classified as emerging markets.

The ACWXUSI weight to emerging markets would be the manager’s normal or neutral weight, but the manager would have the ability to shift this allocation from 0% to 30% on a tactical basis. The mandate would also permit all capitalization ranges: large, medium and small at the manager’s discretion. The manager should have a relatively style neutral or “core” management style, but firms with a slight growth or value bias will be considered.

Risk Controls: Additional risk controls would include:

- Individual issues should not exceed 3% of the portfolio at cost,
- There should be adequate diversification by region, country, and industry sector,
- There should be adequate liquidity for securities held,

- Securities should not be hedged as a normal position, but individual country or regional holdings may be fully hedged. Hedging should not exceed 25% of the overall portfolio.
- Futures, forwards, options, and swaps would be permitted for purposes of hedging the currency exposures of securities holdings. These instruments would not be permitted where they would create leverage, where there is no underlying assets, or for cross-hedging currency positions.

Screens: Candidates will be screened for factors that indicate competence and success, including:

- Appropriate registration and regulatory compliance,
- Longevity, depth, and quality of the management team,
- The existence of current portfolios, or specific product offerings, that meets the desired mandate,
- Minimum levels of \$1 billion in assets in non-U.S. equity mandates.
- Positive performance characteristics over various time frames that demonstrate favorable outcomes relative to the ACWXUSI Index on a risk-adjusted, net of fees basis,
- The existence of appropriate compliance, risk controls, and portfolio monitoring,
- Good communications and client service,
- Competitive fees.

Report to ATRS Board

February 12, 2002

1. Real Estate Investment Committee has met twice – has full complement of 6 members and is set up and ready to go.
The next meeting is on February 19, 2002, at 3:30 p.m.
The time was changed to accommodate Charles Trammell who will address our committee. ATRS Investment Committee meets before us at 1:00 p.m. and will be invited to attend the R/E Investment Committee meeting.
2. All management contracts with The Hathaway Group have been reviewed and found to be acceptable.
Previously all management contracts with Flake and Kelley have been reviewed and approved.
I have met with Dickson Flake of B.Q.F. & A. They have agreed to issue a letter to be attached to each of their 7 management contracts – agreeing to my requested changes. I will be looking at other mgt. Contracts next month.
3. I have had multiple contacts with members of local media to keep them well-informed on the progress toward both accountability and responsibility in our real estate investment procedures. You will note that our press has been positive so far this year and I am working to keep it that way.
4. In regard to the management of the Riley Properties, I have made myself informed and moved to provide you with “alternatives”, if that is your desire. I have re-reviewed the “agreement in principle: with Holman dated June 29, 2001 and the proposed “management services agreement” prepared by Dover and Dixon this month and am ready to submit my findings to the Real Estate Committee, per your instructions.
5. I traveled to Memphis to tour Kirby Pines. I inspected the ATRS site in Chenal Valley – Little Rock. I spent at least a day studying the feasibility study dated November 1999 by Retirement Living Services and the ATRC update of January 29, 2002. I am ready to present my opinions to the R/E Investment Committee.
6. On February 1, 2002 those utilizing the lot-trade property that was a part of the Ark-La Building acquisition were given notice to vacate by March 1, 2002. They have asked to meet with me next Thursday, at which time new parking agreements will be negotiated more in line with your investment in that site.
7. I have studied the ATRS Retirement Community Three-year Management and Marketing Agreement and the Project Administration Agreement, both of which were executed January 2001 and am familiar with both instruments.

Suggestions – Long & Short Term

1. If you proceed with the ATRS Retirement Community, make certain that my presence is required during all material negotiations and meetings so that I will be in a position to provide first-hand, unbiased reports to the ATRS Board.
2. Let my firm prepare a low-cost feasibility study on the Woodland Heights/Riley South property. I am interested in determining whether or not we can use this property to avoid criticism of the inability of the Chenal Retirement Community to meet the financial ability of the "average" retired schoolteacher.
3. Move to let me get those two acquisitions closed this month in W. Memphis and in Texarkana for several reasons:
 - a. I want to show State Bldg. Services that we want to do business with them as tenants. (Victory Bldg.)
 - b. I want geographical diversification in our Arkansas investments.
 - c. I want to have time to advise the appropriate tax assessors by March 1, 2002 of our request to avoid ad valorem taxes on these properties.
4. Give someone the authority to explore our case for limiting liability or immunity from liability on retirement/nursing home properties.
5. Provide me with a list of your most pressing items that need my immediate attention – so that I may proceed in a manner that fits your desires.

Tom M. Ferstl
Real Estate Investment Manager

P.S. It is still my belief that we would be best served to allocate our non-income producing raw land to a different category than our income-producing real estate investments ...this would serve to produce a more realistic idea of what this type property is really giving as to a return to the system. Further, we should also break out out-of-state and Arkansas related properties to give the real estate investment committee an easier target and more clearly defined limits.

1 POLICY TYPE: Governance Process
23 POLICY TITLE: Real Estate Committee Charter
4

- 5 1. There shall be a Real Estate Committee composed of five members—including three
6 members selected from the business community, the Arkansas Banking Commissioner, and
7 the ATRS Real Estate Investment Manager.
8
- 9 a. The Board shall select the ~~three~~six business community members from a list compiled by
10 the Executive Director and the Board. The business community members shall be
11 appointed for one-year terms and may be reappointed. Three members will be selected by
12 the Committee chair to serve at a particular meeting.
13
- 14 b. The ~~three~~six members from the business community shall be knowledgeable about real
15 estate matters. A person will be deemed to be “knowledgeable with respect to real estate
16 matters” if that person is a present or former lending officer for a federally-insured
17 financial institution, or is a licensed Arkansas real estate broker with five years or more
18 experience as such, or is an Arkansas licensed real estate appraiser (state certified general
19 appraiser or MAI designation).
20
- 21 c. The Real Estate Investment Manager will be employed by the Board to review, monitor,
22 and advise on all aspects of the real estate portfolio including management contracts. This
23 will include advice on assets and loans currently in the portfolio as well as future loans
24 and acquisitions. The Real Estate Investment Manager shall have a minimum of ten years
25 experience as a commercial real estate broker, property developer, appraiser, counselor,
26 lender or a combination thereof.
27
- 28 2. No member of the Committee may do business with ATRS while serving on the committee
29 or for a period of three years thereafter.
30
- 31 3. The Real Estate Investment Manager shall serve as Chair of the Committee.
32
- 33 4. The Committee shall operate under guidelines and procedures approved by the Board.
34
- 35 5. The purpose of the Committee shall be to consider and approve or disapprove all real estate
36 investments submitted by the Real Estate Screening Committee. ATRS Legal Counsel must
37 review all such proposals prior to final approval by the Committee.
38
- 39 6. The Committee shall have the authority to renew loans that have matured and performed
40 according to loan documents. This shall include, but not be limited to raising and lowering
41 interest rates, substituting or requiring more collateral and making adjustments in life
42 insurance premiums.
43
- 44 7. Total real estate investments shall not exceed the system’s approved asset allocation as

1 determined by the Board at the beginning of each calendar and fiscal year. Should the real
2 estate allocation be exceeded, no additional real estate investments shall be entered into until
3 the asset allocation exceeds the total real estate investments.
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- 5 8. Minutes of each meeting will be maintained and reports of all actions taken by the
6 Committee will be presented at the following Investment Committee meeting and Board
7 meeting.
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44 Authority:
45 Adopted:

POLICY TYPE: Board-Executive Director Relationship**POLICY TITLE: Delegation to the Executive Director**

Authority for implementing policy and the development of supporting procedures is delegated to the Executive Director

1. All Board authority delegated to staff is delegated through the Executive Director, so that all authority and accountability of staff is considered to be within the authority and accountability of the Executive Director.
2. *Ends* policies direct the Executive Director to achieve certain results; *Executive Director Limitations* policies constrain the Executive Director to act within Board adopted policies, legal requirements and acceptable boundaries of prudence and ethics. With respect to *Ends* and *Executive Director Limitations*, the Executive Director is authorized to establish further procedures, make decisions, and take actions provided they are consistent with Board policies.
3. The Board may change its policies, thereby shifting the boundary between the Board and the Executive Director domains. The Board and Executive Director will respect and support the parameters of delegation as they exist and as they may be changed in the future.

Authority:
Adopted:
Amended:

POLICY TYPE: Board-Executive Director's Relationship

POLICY TITLE: Executive Director's Job Description

The Executive Director is the Board's official link to the operation of the Retirement System. The Executive Director is accountable for all organizational performance and entitled to exercise all authority delegated by official Board action.

The Executive Director's job description may be stated as performance in these areas:

1. Organizational accomplishment of the provisions of Board policies on *Ends*.
2. Organizational operation within the boundaries of prudence and ethics established in Board policies on *Executive Director Limitations*.
3. Serving as Secretary to the Retirement Board and an ex-officio non-voting member of its committees and maintaining an accurate record of the proceedings.

Authority:
Adopted:
Amended:

POLICY TYPE: Board-Executive Director's Relationship**POLICY TITLE: Monitoring Executive Performance**

Monitoring executive performance is synonymous with monitoring organizational performance against Board policies on *Ends* and *Executive Director Limitations*. Any evaluation of Executive Director performance, formal or informal, may be derived only from these monitoring data.

1. The purpose of monitoring is simply to determine the degree to which Board policies are being fulfilled. Information that does not meet this purpose will not be considered to be monitoring. Monitoring will be as automatic as possible, using a minimum of Board time so that meetings can be used to create the future rather than to review the past.
2. A given policy may be monitored in one or more of three ways:
 - a. Internal report: Compliance information prepared by the Executive Director for the Board.
 - b. External report: Compliance information prepared by a disinterested, external auditor, inspector or consultant who is selected by and reports directly to the Board. Such reports must assess executive performance only against policies of the Board, not those of the external party unless the Board has previously indicated that party's opinion to be the standard.
 - c. Direct Board inspection: Compliance information prepared by a Board member, a committee or the Board as a whole. This is a Board inspection of documents, activities or circumstances directed by the Board that allows a "prudent person" test of policy compliance.
3. Upon the choice of the Board, any policy may be monitored by any method at any time. For regular monitoring, however, each *Ends* and *Executive Director Limitations* policy will be classified by the Board according to the following frequency and method:

Policy	Method	Responsibility	Frequency	Month Expected
Ends				
Financial Perspective				
Customer Perspective				
Internal Business Process Perspective				
Learning and Growth Perspective				
Executive Director Limitations				
General Executive Constraints				
Communication and Counsel to the Board	Direct Board Inspection	Board	Annual	June
Code of Ethics				
Compensation and Benefits				
Staff Treatment				
Operations				
Risk Management				

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* Every five years another independent actuary will review the actuarial soundness of the system. (The last actuarial audit was conducted for FY XXXX.)

Authority:
Adopted:
Amended:

POLICY TYPE: Board-Executive Director Relationship

POLICY TITLE: Employment of Executive Director

Employment of the Executive Director will be by the Board. ~~The terms of employment for the Executive Director will be by contract.~~

1. Employment will be based on the Board's judgment that a candidate's knowledge, skill and character would indicate reasonable assurance of excellent performance.
2. Criteria will be based on:
 - a. General characteristics set forth by the Board to predict successful Executive Director performance, and
 - b. Specific characteristics set forth by the Board to predict successful Executive Director performance in view of the Retirement System's strategic challenges in the future.
3. Prior to selecting an Executive Director, the Board will make explicit provisions for:
 - a. Providing notice of the vacancy,
 - b. Screening nominations or applications, and
 - c. The selection process.

Authority:
Adopted:
Amended: