

MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING

Dr. Richard Abernathy, Chair

Monday, October 4, 2010

1:00 p.m.

1400 West Third Street
Little Rock, AR 72201

Board Members Present

Dr. Richard Abernathy, Chair
Hazel Coleman, Vice Chair
Lloyd Black
David Cauldwell
Charles Dyer
Dr. Tom Kimbrell
Beverly Leming
Bobby G. Lester
Susannah Marshall, designee for Candace Franks
Donna Morey
Robin Nichols
Janelle Riddle
Jeff Stubblefield

Board Members Absent

Honorable Martha Shoffner
Honorable Jim Wood

Consultants Present

Michael Bacine, Franklin Park
Heather Christopher, Ennis Knupp
P. J. Kelly, Ennis Knupp

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

Staff Present

George Hopkins, Executive Director
Susan Crosby, Senior Investment Analyst
Kay Daniel, Director's Assistant
Dena Dixon
Reed Edwards, Litigation Attorney
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Michael Ray, Dir. Member Services
Gaye Swaim, Dir. Human Resources
Leslie Ward, Dir. Private Equity
Brenda West, Dir. Operations

Guests Present

Bill Birch, Bancorp South Insurance
Chris Caldwell, Division of Legislative Audit
Sarah Ganahl, Bureau of Leg. Research
Erika Gee, Attorney General's Office
Richard Hutchison, AEA
Steve Singleton, ARTA
Charles Tadloch, ARTA

I. **Call to Order/Roll Call.** Chair, Dr. Richard Abernathy, called the Board of Trustees meeting to order at 1:00 p.m. Roll call was taken. Honorable Martha Shoffner and Honorable Jim Wood were absent.

II. **Adoption of Agenda.**

Ms. Leming moved for adoption of the Agenda. Ms. Morey 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. **Approval of Board of Trustees Minutes of July 22, 2010.**

Mr. Lester moved for approval of the Minutes of the Board of Trustees meeting of July 22, 2010. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

V. **Investment Committee Report.** Ms. Leming gave an update on the Investment Committee meeting.

A. **Proposed Board Policy Changes.**

1. **General Investment Policies.** ATRS staff and consultants agreed there was a need to review and update ATRS general investment policies to be more compliant with ATRS practice. Staff and consultants performed a line-by-line revisal and made minor adjustments to terminology based on actual practice and market provisions.

Ms. Leming moved to approve the changes to the General Investment Policies. Ms. Nichols seconded the motion, and the Board unanimously approved the motion.

2. **Real Estate Policies.** ATRS staff and consultants agreed there was a need to review and update ATRS real estate policies to be more compliant with ATRS practice. Staff and consultants performed a line-by-line revisal and made changes to bring greater clarity to the terminology and to certain provisions. General terms were added to clarify the total scope of the investment area, such as the addition of financing to the real estate asset class. The pacing concept, long-term investments used to bring investment classes to certain levels, is now a specific part of the policy.

Changes were made to Arkansas held real estate to clarify how Arkansas related investments are to be treated and ensure that ATRS practice is in compliance with policy.

Ms. Leming moved to approve the changes to the Real Estate Policies. Ms. Morey seconded the motion, and the Board unanimously approved the motion.

3. **Private Equity Policies.** ATRS staff and consultants agreed there was a need to review and update ATRS private equity policies to be more compliant with ATRS practice. Since the guidelines were flexible, the changes to the policy were minor in nature.

Ms. Leming moved to approve the changes to the Private Equity Policies. Ms. Riddle seconded the motion, and the Board unanimously approved the motion.

B. Arkansas Real Estate Update.

1. **Timberland Acquisition.** ATRS completed a purchase of an 11,872 acre pine plantation in Pike and Clark counties for \$15 million and expects a conservative estimate of 9+% rate of return. Conditions are excellent for ATRS to purchase timberland tracts because owners are downsizing timberland holdings due to cash flow needs and liquidity issues.
2. **Victory Building.** The Victory Building is currently 90.4% occupied. A prospect appears to be ready to finalize a leasing agreement, which would bring the Victory Building to 97.5% occupation.
3. **Woodland Heights.** Woodland Heights is just over 50% occupancy. The marketing plan and new manager seem to be improving Woodland Heights operations. Based upon current occupancy and expenses, ATRS is receiving a positive cash flow from Woodland Heights.
4. **Chenal Heights.** ATRS successfully closed the sale of Lots 7 and 8 to the Pickering Allwine Group. The transaction proceeded without any issues. Pickering Allwine has also expressed interest in purchasing additional lots. ATRS is not aggressively marketing the remaining lots, but has let the real estate community know that the remaining 52.64 acres is available for sale.
5. **Tax Lawsuit Update.** A trial was held in Garland County and a decision is expected within the week. Ultimately, the case will be decided upon by the Supreme Court and it is expected to favor ATRS.
6. **Farmland Investment Vehicle.** ATRS staff has been working with the real estate consultant to determine if ATRS should invest in farmland. Overall, the return of farmland is favorable and can be a high-quality, long-term investment. The difficulty in purchasing farmland is that it requires significant expertise, so it was concluded that a separate account manager, along the lines with RMK Timberland, would be

necessary. ATRS would fund this manager between \$50 million and \$100 million to allow adequate purchases for diversification and justification for the cost of setting up a separate account.

Ms. Leming moved to approve the hiring a separate account manager for farmland investment and to allocate between \$50-\$100 million for fund diversification. Ms. Morey seconded the motion, and the Board unanimously approved the motion.

C. General Investment Consultant Update – Ennis Knupp.

1. **Portfolio Performance Update for the Quarter Ended June 30, 2010.** The second quarter markets were down due to the May 6th “Flash Crash”, in which the U.S. stock market fell by almost 10% in a span of less than 30 minutes. The market recovered most of its losses by the end of the day, but this event was damaging to investor confidence. Concerns over the ongoing Gulf oil spill and European sovereign finances also affected the market performance.
2. **Portfolio Performance Update for the Month Ended July 31, 2010, preliminary.** The total fund was up 4.1%, slightly trailing the benchmark of 4.7% for the month ended July 31, 2010, despite a rebounding market. Due to the fund’s conservative positioning, the fund performs well when the market is down but lags the benchmark when the market goes back up. Global equity was the biggest detractor to the fund.
3. **Portfolio Performance Update for the Month ended August 31, 2010.** The fund was down -2%, slightly above the benchmark of -2.1%, for the month ended August 31, 2010. The fixed income portfolio matched the benchmark of 1.3%. Pershing Square was the highest performing U.S. equity manager for the month, at -0.5%, beating the benchmark of -4.7%. Wellington Opportunistic, Knight Vinke, Lincoln Vale, and Bedlam were some of the better performing global equity managers for the month. Fixed income managers beat benchmarks across the board, except for Loomis Sayles.
4. **DE Shaw Benchmark Update.** The current benchmark for DE Shaw is the MSCI All World Index, which includes emerging markets. The ATRS guidelines for DE Shaw do not include emerging markets, which are a part of the MSCI All World Index. DE Shaw requested, and consultants and ATRS staff agreed, that the benchmark be modified to a new benchmark that does not include emerging markets. The new

proposed benchmark is the MSCI World Index as it more appropriately reflects DE Shaw's investment strategy.

Ms. Leming moved to approve the proposed DE Shaw Benchmark update. Ms. Nichols seconded the motion, and the Board unanimously approved the motion

5. **Lazard Guideline Change.** The current Lazard guidelines require that Lazard maintain a real-time diversification in stocks, countries, and markets segments. The Lazard trading process is very complex, and the current guidelines make this process more difficult for Lazard to consistently maintain diversification. Lazard requests that the guidelines be changed to eliminate the real-time reporting, making the process less difficult and allowing Lazard to make the necessary adjustments to ensure diversification. This change will not affect the investment process used by Lazard.

Ms. Leming moved to approve the proposed Lazard Guideline change. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

6. **Recommendation to Allow Staff to Sign Contract Amendment due to the Hewitt Ennis Knupp/Aon Merger.** At the previous Investment Committee meeting, the merger between Hewitt and Ennis Knupp was discussed. At that time, Hewitt and Aon were also in merger discussions, and that merger is now ready for completion. The Hewitt Ennis Knupp group ask that ATRS approve the Aon merger as it did the Hewitt Ennis Knupp merger. There will be no material changes to Ennis Knupp's consulting process.

Ms. Leming moved to approve staff to sign the Hewitt Ennis Knupp contract amendment due to the merger with Aon. ??? seconded the motion, and the Committee unanimously approved the motion.

D. Real Estate Consultant Update – Ennis Knupp.

1. **Real Estate Portfolio Performance Update for the Quarter Ended June 30, 2010.** The net IRR for the portfolio was 3.8% for the quarter ended June 30, 2010. Total portfolio leverage remained substantially unchanged from the prior quarter. The fund has matched its NPI benchmark over the trailing 10 year period.

ATRS' 2010 pacing projections call for one \$40 million value-added commitment and one \$35 million opportunistic commitment.

E. Private Equity Investment Consultant Update – Franklin Park.

1. **Private Equity Market and Portfolio Update for the Quarter Ended June 30, 2010.** Since inception, \$2.3 billion has been committed to private equities through June 30, 2010. The portfolio has returned 1.3 times invested capital and generated a net IRR of 7.9%.

Of the 2010 commitments to date, Wellspring V and Mason Wells III have closed. There are three commitments that Franklin Park expects to present during the next Board of Trustees meeting.

VI. Operations Committee Report.

A. Proposed Board Policy Change.

1. **Rule 3-8, Compensation and Benefits.** The current Rule 3-8 directed the ATRS Executive Director to notify the Board of any employment changes concerning all staff members above the formerly existing Grade 23. The Arkansas State employee pay grade system changed in July 2009 to a new numbering system. ATRS staff recommends that the policy be changed to reflect the new numbering system and to clarify that this policy does not apply to temporary help positions.

Mr. Lester *moved to approve* changes to Rule 3-8, Compensation and Benefits, to reflect the July 2009 Arkansas State employee pay grade changes. Ms. Nichols *seconded the motion*, and the Board *unanimously approved the motion*.

B. Potential Legislation

1. **T-DROP Reduction to Include Reciprocal Service Years.** The current T-DROP reduction formula for members who are only with ATRS reduces benefits for each year of ATRS service to calculate the T-DROP monthly deposit. This reduction does not count the years of reciprocal service from other systems. The proposed change would count the service years with reciprocal systems as well as ATRS service years when calculating the reduction for monthly T-DROP deposits. The change would require legislation.

Mr. Lester *moved to approve* the proposed legislation changing the T-DROP calculation to include reciprocal service years. Ms.

Morey seconded the motion, and the Board unanimously approved the motion

2. **Extend Termination Period to Two Years Post Retirement.** The Committee did not recommend this proposal to the Board.
3. **Length of Service Credit Requirements Expanded to 160 Days.** Currently, a full year of service is equivalent to 120 days. The proposal was for lengthened time in the amount of 160 days. From a cost savings standpoint, the longer the service requirement, the greater the savings. The service requirement has not been updated since 1971 and the school year has lengthened during that time, justifying the need to lengthen days required for service credit.

Mr. Lester moved to approve the proposed legislation of lengthening the service credit requirements from 120 days to 160 days. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

4. **Disability Retirement Requirements Strengthened.** ATRS' current disability requirements have a fairly low threshold, which has significantly increased costs for ATRS. ATRS currently has approximately 10% of its retirees on disability retirement. The actuary and staff reviewed the disability requirement standards for ATRS, and have proposed to raise the standards to match the requirements currently used by Arkansas Public Employees Retirement System (APERS). Use of the higher standards would amount to an actuarial savings equal to a reduction of 1.5 years to the ATRS amortization period.

Mr. Lester moved to approve staff's recommendation to strengthen the current ATRS disability retirement requirements language. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

5. **College Participation.** Since the Attorney General's opinion in the fall of 2009, participation by colleges has been uncertain and difficult to administer. Colleges are allowed to decide which of their employees participate and which do not. ATRS staff proposes to allow colleges to grandfather existing employees who are members of ATRS into continued participation with ATRS. For new hires after the effective date of the law, a college would have to opt into ATRS participation. As part of that opt in, the college would agree to share information with ATRS in order for ATRS to comprehensively monitor the employees of

the college to ensure compliance with ATRS laws and policy. In addition, new hires at a college could only enroll in ATRS if the employee was “benefits eligible” at the college, a full-time employee, and already vested at the time of employment. Otherwise, the employee would not be allowed to enroll in ATRS. This will be a significant cost savings to ATRS while still allowing the college to use ATRS as a recruiting tool for needed full-time employees. ATRS staff is continuing to work with colleges towards a solution.

Mr. Lester moved to approve staff’s recommendation to draft legislation regarding college participation in ATRS. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

6. **T-DROP Rollover Options Expansion.** Currently ATRS policy allows retirees to either withdraw the entire amount in T-DROP, or to annuitize the entire amount. Many members have expressed interest in annuitizing partial amounts with ATRS, and withdrawing the balance. The proposed legislation would allow members to leave 25%, 50%, or 75% with ATRS in addition to the current options. This would allow members more flexibility and provide ATRS a greater chance of retaining more T-DROP funds for better liquidity and continued investment.

Mr. Lester moved to approve staff’s recommendation to draft legislation regarding T-DROP rollover expansion options. Mr. Black seconded the motion, and the Board unanimously approved the motion.

- VII. **Fiduciary Insurance.** At the July 22, 2010, Board meeting, the Board delayed action on the proposal so that ATRS staff could look further into the issue of fiduciary insurance. Mr. Bill Birch, of Bancorp South Insurance, presented updated fiduciary insurance quotes to the Board. There were three options: Option #1 with \$10 million coverage and a \$122,450 premium, Option #2 with \$5 million coverage and a \$78,250 premium, and Option #3 with \$1 million coverage and a \$39,950 premium.

Mr. Lester moved to approve the purchase of Fiduciary Insurance for the Board of Trustees, with coverage of \$10 million and a premium of \$122,450. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

- VIII. **Audit Committee.** Mrs. West presented information on the Audit Committee to the Board. The Audit Committee has not met since 2008. There has been

two outside accountant resignations since that time. The Board was provided with a list of potential replacements that have an expressed interest in serving on the Committee. The Board requested additional names from the private sector by the next meeting of the Board. Mrs. West also informed the Board that Internal Audit has developed an annual audit plan, has updated the agency's disaster recovery plan, assisted with biennial budget, and begun prioritization of open IT tickets.

- IX. **Review of the ATRS Legislative Audit Report, June 30, 2009.** A copy of the ATRS Legislative Audit Report, June 30, 2009, was provided for the Board's review. There were no significant problems that needed to be addressed.

Dr. Kimbrell moved to accept the ATRS Legislative Audit Report, June 30, 2009. Ms. Leming seconded the motion, and the Board unanimously approved the motion.

- X. **Trustee Travel (Resolution 2010-27).** Mr. Hopkins explained to the Board that, under current policy, Trustees may only travel to NCTR and SCTR sponsored conferences. Some Trustees have indicated that they may be more interested in attending conferences and meetings that have a focus on investments or operational issues outside of these organizational sponsored conferences. This resolution would require action to allow Trustees to attend other types of conferences.

Ms. Coleman moved to adopt Resolution 2010-27, authorizing the reimbursement of Board Trustees' travel to Board related conferences and meetings. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

- XI. **2011 Board of Trustees Election Schedule.** Mr. Hopkins presented the 2011 Board of Trustees Election schedule. The fourth congressional district trustee position will expire June 30, 2011. ATRS will begin the RFQ process to find an election vendor, place notices in statewide educational publications, and post information on the ATRS website.

- XII. **Medical Committee Reports.** Mr. Ray presented the Medical Committee reports. In June 2010, nineteen disability applicants were considered, eighteen were approved and one was denied. In July 2010, twenty-one applicants were considered, twenty were approved, and one was denied. In August 2010, twelve applicants were considered and all were approved. In September 2010, sixteen applicants were considered, thirteen were approved, and three were denied.

Ms. Nichols *moved to approve* the Medical Committee reports from June 2010, July 2010, August 2010, and September 2010. Mr. Lester *seconded the motion*, and the Board *unanimously approved the motion*.

XIII. **Other Business.**

XIV. **Adjourn.**

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

Meeting adjourned at 2:30 p.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Amy Glavin,
Recorder

Date Approved