MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING
Dr. Richard Abernathy, Chair

Monday, December 5, 2011
1:00 p.m.
1400 West Third Street
Little Rock, AR 72201

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

Board Members Absent
Bobby Lester

Guests Present
Shane Benbrook, Audit Committee
Alex Blankenship, Div. Legislative Audit
Chris Caldwell, Div. Legislative Audit
Erika Gee, Attorney General's Office
French Hill, CEO, Delta Trust
Karen Holliday, Bureau of Leg. Research
Bob Leming
Jacqui Lyons, State Street Bank
Scott Paton, State Street Bank

Staff Present
George Hopkins, Executive Director
Gail Bolden, Deputy Director
Chris Ausbrooks, Senior Software Support
Bob Berry, Chief Fiscal Officer
Kay Daniel, Director's Assistant
Dena Dixson, Internal Audit/Risk Mgmt
Reed Edwards, Litigation Attorney
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Wayne Greathouse, Dir. Public Markets
Clementine Infante, Attorney
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Chris Onnen, Info. System Analyst
Willana Prince, Ret. Section Manager
Tammy Porter, Paralegal
Michael Ray, Dir. Member Services
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Internal Audit/Risk Mgmt

Consultants Present
Michael Bacine, Franklin Park
Heather Christopher, Hewitt EnnisKnupp
Judy Kermans, Gabriel, Roeder, Smith & Co
Brian Murphy, Gabriel, Roeder, Smith & Co
Laurel Nicholson, Hewitt EnnisKnupp
Chris Reel, Hewitt EnnisKnupp
Tom Schoenbeck, Hewitt EnnisKnupp

Reporters Present
Mike Wickline, Arkansas Democrat Gazette

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. Lloyd Black and Honorable Charlie Daniels were absent.

II. **Motion to Excuse Absences.**

Mr. Knight *moved* to *excuse* Bobby Lester from the December 5, 2011, Board of Trustees meeting. Mr. Black *seconded* the *motion*, and the Board *unanimously approved the motion.*

III. **Adoption of Agenda.**

Ms. Coleman *moved* for *adoption* of the Agenda. Ms. Gram *seconded* the *motion* 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 Minutes.**

A. **Scriveners Error - Minutes of July 19, 2011.** The minutes reflected that Board action on a potential real estate acquisition for the insurance department was done in the form of a resolution. The resolution was not used and the Board approved a motion to allow the negotiation. Therefore, a scrivener error exists since a resolution, as reflected in the minutes, was not approved. The purpose of this is to modify the amendments to reflect that the motion passed, rather than a resolution.

Ms. Nichols *moved* for *approval* of the amended Minutes of the Board of Trustees meeting of July 19, 2011. Ms. Coleman *seconded* the *motion*, and the Board *unanimously approved the motion.*

B. **Minutes of October 24, 2011.**

Ms. Leming *moved* for *approval* of the Minutes of the Board of Trustees meeting of October 24, 2011. Dr. Kimbrell *seconded* the *motion*, and the Board *unanimously approved the motion.*

VI. **Preliminary Actuarial Valuation Presentation.** Mr. Murphy and Ms. Kermans presented the preliminary actuarial valuation results. The funding objectives for ATRS are intergenerational equity with respect to plan costs, a stable pattern of contribution rates, and a ratio of assets to liabilities at 100%. To meet these objectives, ATRS needs reasonable forecasts of resources and obligations, smoothing devices, funding discipline, and a sound investment program.

Since 2010, the number of active, inactive, and retired members increased, while the number of members in T-DROP decreased. Overall, there was a 1.6% change in the total covered population since 2010. Active members had an annual earnings growth of 3.08%. T-DROP members showed a drop in number (4,487 for 2011 compared to 4,608 in 2010), and a drop in payroll ($271 billion for 2011 compared to $275 billion in 2010). Deferred members showed a growth in number (12,404 in 2011 compared to 11,924 in 2010), and a growth in vested benefits ($57 billion in 2011 compared to $54 billion in 2010). Retired members showed a growth in number (32,099 in 2011 compared to 30,587 in 2010), and a growth in benefits paid ($657 billion in 2011 compared to $613 billion in 2010).

Total accrued liabilities and applicable assets showed a growth from 2010 to 2011. The agency is 72% funded, down from 74% in 2010. The amortization years grew from 52 years in 2010 to 66 years in 2011. The investment return for the year was favorable compared to the 8% assumed return. The market value rate return was 22.61%.

Investment performance in 2011 was good, but there were significant losses in 2008 and 2009. The gains and losses are smoothed over a four year period, so that prior losses are offset by any current and prior investment gains. This caused an increase in the amortization period and a decrease in the funded ratio.

In 2011, the Board enacted substantial legislation to reduce costs. Some of the legislative changes produced immediate results and impacted the amortization period for the June 30, 2011, valuation. Most of the legislative changes will act to decrease the amortization period over the next several years as cost savings are realized.

Overall, unless there is a substantial investment gain in 2012, the amortization period is likely to increase significantly. It is unlikely that the present 14% employer contribution rate can return ATRS to a 30 year amortization period in the near term. Either an investment return of over 8% or an employer contribution rate of more than 14% is needed to get back to a 30 year amortization period.

VII. **Statement of Financial Interest.** Mr. Hopkins reminded the Board about the annual statement of financial interest. ATRS Trustees must file a Statement of Financial Interest by the end of January 2012, for their financial information for calendar year 2011.

VIII. **Proposed 2012 Board of Trustees Meeting Schedule.** Mr. Hopkins presented the proposed 2012 Board of Trustees meeting schedule.

Discussion followed on conflicts with the dates for the Educational Seminar and following Board meetings.

IX. **Report of Member Interest Waived under A.C.A. Sec. 24-4-205.** Mr. Hopkins reported on member interested waived since October 2011.

X. **Report of Employer Interest and Penalties Waived under A.C.A. 24-7-411.** Mr. Hopkins reported on employer interest and penalties waived since October 2011.

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

A. **Internal Audit Report – Review of Internal Controls Over the Reconciliation Process for Act 793 Annuity Payments and Reimbursements.** Employees of the Department of Human Services who were members of the Arkansas Teacher Retirement System (ATRS) and met certain requirements of Act 793 of 1977 were eligible to transfer their active membership effective January 1, 1978, from ATRS to Arkansas Public Employees Retirement System (APERS) provided such election was made on or before June 30, 1991. ATRS is liable for funding of benefits for credited service established with the System prior to January 1, 1978. APERS is responsible for submitting all benefits due under Act 793 to the member. APERS bills ATRS monthly for ATRS' portion of the members' benefits.

The object of the audit was to access the Accounting/Retirant Payroll Department's internal controls over the reconciliation process for Act 793 annuity payments for the month of June 2011.

Internal Audit made several observations. The Accounting/Retirant Payroll Department had inadequate written policies and procedures. Reconciliations not done in a timely manner. There was a lack of consistency in calculation of Act 793 benefits. Act 793 members' screens contained errors due to information not being entered and updated in a timely manner to ATRMIS (ATRS' membership information system). Reserve accounts were not accurately reported in the Agency's financial records. Act 793 member documentation was not scanned into Docmage (ATRS' document storage system) in a timely manner. ATRS did not reimburse APERS in a timely manner for lump sum Drop payments. As of June 30, 2011, ATRS owed APERS approximately $1,120,269 for lump sum payments going back several years. The agency had paid $411,933 of this amount, leaving a balance of $708,336 still outstanding as of November 20, 2011. The liability was not booked in the financial records at the end of the fiscal year.

The Internal Audit department believes the Accounting/Retirant Payroll department has internal controls that are inadequate in regards to Act 793 reconciliations and presented recommendations to establish and implement adequate procedures.

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

A. **Arkansas Holding Update.**

1. **Victory Building Update.** The fitness center, Snap Fitness, is now open. Engstrom Engineering has been engaged to inspect and advice ATRS regarding water-proofing and maintenance issues associated with the parking deck.

2. **Woodland Heights.** ATRS staff continues to enhance the appearance and amenities of Woodland Heights. A new chef has been hired and is performing well. The weak housing economy has made it difficult to maintain a flow of new residents. However, occupancy has increased to 68.5%.

3. **South Center in Hot Springs.** Ross Dress for Less is on schedule to open during the Easter season. Once Entergy has installed a new transformer, all obligations by ATRS will be complete.

4. **Farmland Update.** A 739 acre corn and soybean farm in Warren County, Indiana, has been purchased by Halderman, ATRS' farmland manager. The total purchase price was approximately $5 million, which is more expensive than Delta farmland due to higher output. ATRS currently has approximately $14.75 million in farmland investments to date.

5. **1500 West 3rd Lease.** ATRS has come to an agreement with the Arkansas Insurance Department to lease 6,000 square feet at 1500 West 3rd. Some engineering work is required before the department can move.

6. **Other Opportunities.** ATRS staff continues to receive information on various investment opportunities in Arkansas. The philosophy of ATRS staff has been that additional Arkansas investments should be outstanding in every respect with a strong opportunity for significant gains with low risk. Such properties are hard to find but will continue to be on the radar screen of ATRS staff and the consultants.

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

1. **Preliminary Portfolio Performance Update for the Month Ended October 31, 2011.** The total fund returns were positive for the month ended October 31, 2011, at 6.9% return, but performed under the benchmark of 7.2%, despite outperformance in all asset classes. The long-term numbers show outperformance over more recent numbers, so Hewitt EnnisKnupp will look at overall asset allocation in the near future to see if these allocations still fit the ATRS portfolio. The results will be presented in early 2012.

2. **Co-Investment Program Due Diligence Considerations.** Hewitt EnnisKnupp believes co-investment programs are appropriate for large, sophisticated clients, but due diligence should be conducted before allocation to a co-investment program. Hewitt EnnisKnupp presented due diligence questions for ATRS staff and Franklin Park to consider and answer.

3. **Securities Lending Overview.** Securities lending requires an agent to lend broker/dealers securities from the plan sponsors. The broker/dealer deposits collateral and collateral is marked to market daily. The plan sponsor retains all dividends. State Street, ATRS' custodian, retains 18% of gross lending income as a fee. ATRS retains 82% of gross lending income. The risks that accompany securities lending are that the broker may not be able to return the securities when needed, back-office operation failure, and the collateral losing value. State Street offers indemnification against borrower and operational risk.

   Hewitt EnnisKnupp views State Street's 2010 decision to restructure collateral pools favorably. Though net lending income has decreased over the years, ATRS continues to earn income from the program. Hewitt EnnisKnupp recommends maintaining the securities lending program and retaining State Street as the securities lending agent.

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

1. **Preliminary Portfolio Performance Verbal Update for the Quarter ended September 30, 2011.** The third quarter was relatively volatile. NCREIF was up 3%, with ATRS slightly trailing at 2% for the quarter. There was relatively little movement in property values.

2. **2012 Pacing Plan Presentation – Total for 2012: $100 Million.** Hewitt EnnisKnupp recommends one to two value added commitments totaling up to $60 million and one opportunistic commitment totaling up

to $40 million for 2012, for a total of $100 million. If the equity or fixed income portfolios experience strong gains in the fourth quarter of 2011, the amounts may be adjusted.

Ms. Leming *moved* to *approve* the recommendation of the Hewitt EnnisKnupp Real Estate Pacing Plan for 2012 and a commitment of $100 million. Ms. Nichols *seconded* the *motion*, and the Board *unanimously approved the motion.*

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

1. **Recommendation to Fund DW Healthcare III for $40 Million (Resolution 2011-31).** DW Healthcare III is targeting commitments of up to a maximum of $300 million. The fund is being formed to make control investments in small healthcare companies based in North America, targeting growth buyouts of specialty device manufacturers, product manufacturers, distributors, and service businesses typically seeking institutional capital for the first time.

   The Investment Committee recommended a commitment of up to $40 million, subject to satisfactory negotiation of final documentation.

   Ms. Leming *moved* to *adopt* Resolution 2011-31, approving a commitment of up to $40 million for DW Healthcare III. Ms. Morey *seconded* the *motion*, and the Board *unanimously adopted the resolution.*

2. **Pacing Analysis and Recommendation – Total for 2012: $235 Million.** Typically, ATRS has been pacing up to 2% of its underlying value for private equity for the next calendar year. Based upon the average total assets of ATRS for the last eight quarters, and in order to maintain a 10% private equity allocation, the Investment Committee recommended a commitment of approximately $235 million in 2012.

   Ms. Leming *moved* to *approve* the recommendation of the Private Equity Pacing Analysis for 2012 and a commitment of up to $235 million. Mr. Knight *seconded* the *motion*, and the Board *unanimously approved the motion.*

3. **Recommendation of up to $25 Million for FP Venture Fund 2012 (Resolution 2011-32).** . The Investment Committee recommended a commitment of up to $25 million into the FP Venture Fund 2012 for its enhanced portfolio returns, low risk, access to otherwise inaccessible managers, and outsourced portfolio management.

Ms. Leming *moved* to *adopt* Resolution 2011-32, approving a commitment of up to $25 million for the FP Venture Fund 2012. Ms. Nichols *seconded* the *motion*, and the Board *unanimously adopted the resolution.*

4. **Recommendation of up to $25 Million for FP International Fund 2012 (Resolution 2011-33).** The primary rational for international investing is to generate enhanced returns, opportunities to benefit from higher earnings growth in certain developing markets, and opportunities to exploit market inefficiencies. The Investment Committee recommended a commitment of up to $25 million to the FP International Fund 2012.

   Ms. Leming *moved* to *adopt* Resolution 2011-33, approving a commitment of up to $25 million for the FP International Fund 2012. Ms. Morey *seconded* the *motion*, and the Board *unanimously adopted the resolution.*

5. **Recommendation, if approved, of up to $25 Million for FP Co-Investment Fund (Resolution 2011-34).** Co-investments are direct investments in portfolio companies alongside private equity fund managers. Investments involve minority ownership positions and are made on the same terms as fund managers, except with limited governance rights. Co-investments would add incremental returns to the overall private equity portfolio, reduce overall costs associated with the private equity program, and leverage existing relationships. Franklin Park will structure the co-investment vehicle and manage the investment selection and oversight process. This will include sourcing co-investments from top-performing managers, performing due diligence on deals, reviewing and executing legal documentation, and monitoring transactions while providing quarterly reporting.

   The Investment Committee recommended allocating up to 10% of ATRS' private equity annual commitment amount ($25 million) to the co-investment program. If the Board approves the commitment to the FP Co-Investment fund, Franklin Park proposes an additional annual consulting fee of $250,000 to source, evaluate, and monitor the co-investment transactions.

   Ms. Leming *moved* to *adopt* Resolution 2011-34, approving a commitment of up to $25 million for the FP Co-Investment Fund. Mr. Black *seconded* the *motion*, and the *motion carried.* Ms. Coleman abstained from voting.

6. **Potential Recommendation to Amend Franklin Park Consulting Contract and Fee Change of an Additional $250,000 Per Year – Contingent upon the Co-Investment Decision (Resolution 2011-35).** If the ATRS Board approves the co-investment plan proposed by Franklin Park and ATRS staff, then Franklin Park is entitled to a fee increase to address the greater scope of additional work. The Investment Committee recommended that the Franklin Park contract be modified for an increase of $250,000 in the annual fee with the first fiscal year fee pro-rated. Staff believes the increase is justified due to Franklin Park's additional commitment of resources necessary to establish the fund, conduct due diligence on individual companies and monitor performance of the companies selected for the fund.

   Ms. Leming *moved* to *adopt* Resolution 2011-35, amending the Franklin Park Consulting contract to increase the annual fee by $250,000 per year due to the additional commitment of the co-investment fund. Mr. Knight *seconded* the *motion*, and the *motion carried.* Ms. Coleman abstained from voting.

XIII. **Operations Committee Report.** Mr. Abernathy gave a report on the Operations Committee meeting.

A. **Potential Legislation.**

1. **1% T-DROP Reduction for Noncontributory Members.** Currently, ATRS has a 1.0% reduction in the T-DROP deposit for each contributory year of service a member has with ATRS. ATRS has a 1.0% reduction for each reciprocal year 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. For clarity and ease of administration, a 1% across the board would be easier to administer and explain. In addition, this "advantage" does provide some incentive for a member who is noncontributory to elect to become contributory while an active member of ATRS.

   Generally, the ATRS Board has provided contributory members with greater benefits (death benefits are higher for contributory members) than for noncontributory members as an incentive for members to be contributory. The current T-DROP provision is actually contrary to that philosophy and encourages noncontributory service when available to a member. In addition, requiring 1% for all service would be a cost savings since a noncontributory member would receive the same 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.

The Committee recommended to the Board to advise staff to move forward in developing this into legislation.

2. **Disability Benefit Paid Only Back to Date Application is Filed.** Currently a member can obtain a quarter year 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 they didn't work, even if that were twenty-two (22) 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 ATRS is 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.

   The Committee recommended to the Board to advise staff to move forward in developing this into legislation.

3. **Require Five Years of Actual ATRS Service for both Disability and Retirement 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. 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. ATRS staff suggests that the Committee study requiring five (5) years of actual service with ATRS before the member obtains either disability or survivor benefits. This 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.

   The Committee recommended to the Board to advise staff to move forward in developing this into legislation.

4. **Inactive Members with Only Noncontributory Service Lose One Noncontributory Year for Each Year the Member is Inactive.** The

executive director and deputy director visited with Gabriel Roeder Smith & Company at their offices recently to review new legislation and developing issues in other plans. One of the discussions centered on the noncontributory years of inactive members. Some systems are looking at noncontributory years being removed over time if the inactive member remains inactive for long periods of time. This is a cost saving measure to consider that should be consistent with recruiting and retaining quality people to help deliver educational services. This would be a cost saving measure that would not affect members who continue to work at an ATRS employer from time to time.

The Committee recommended to the Board to advise staff to move forward in developing this into legislation. The Board requested the actuary, Gabriel, Roeder, Smith & Company, do further cost savings studies on this matter.

5. **Relook at Salary and "Pensionable Wages" for ATRS Salary Calculation.** Often the definition of salary can be a method of saving costs by ensuring that only certain "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 staff, after meeting with Gabriel Roeder Smith & Company, feels that executive staff and Gabriel Roeder Smith & Company should carefully examine the definition of salary that is currently used in the calculation of final average salary at ATRS and report back to the Operations Committee and Board on any salary types currently in use that should be removed from "pensionable salary.

   The Committee recommended to the Board to advise staff to move forward in developing this into legislation.

6. **T-DROP Cash Balance Account.** ATRS staff has worked with the tax attorney to develop a draft rule to allow a member exiting T-DROP to leave an interest bearing account with ATRS, much like rolling the balance to another administrator.

   The Committee recommended to the Board to advise staff to move forward in developing this into legislation.

B. **Independent Actuarial Review to Comply with Rule 3-4.** ATRS staff stated they would look to see what should be done if the Board wanted to forego having an independent actuarial review. ATRS executive staff, after looking at the policy and circumstances, recommends that at the next Board meeting, ATRS have an amendment to the existing rules to eliminate the requirement for this provision. The Board requested that this item be added to the next meeting agenda.

C. **Benefit Payments to a Special Needs Trust for an Incapacitated Child.** Currently, ATRS has laws which allow an incapacitated child to be designated with the same options available to a spouse. The incapacitated child cannot be paid directly. The payments are made at the direction of a guardian. Recently, more updated legal processes and trust vehicles such as a special needs trust are being established for these incapacitated children. ATRS staff has examined ATRS laws in regard to payments on behalf of an incapacitated child. A special needs trust can only be used for the purpose of benefiting the incapacitated child and also has certain protections for the incapacitated child within the trust provisions.

ATRS staff has determined that ATRS law allows and it is appropriate for ATRS to pay the option benefits on behalf of an incapacitated child, either to the guardian or to such a trust, if the trust is acknowledged in a guardianship order as an authorized place for funds for the incapacitated child to be placed. Some members in the past may have been told that ATRS would not pay benefits into a trust for an incapacitated child. ATRS tries to liberally interpret and construe the laws to benefit members, while at the same time, informing the Board and staying within required law and policy. This issue had never undergone a thorough legal review or executive analysis. In order to keep the Board fully informed of issues regarding benefits, staff wanted the Board to know, through this item, that ATRS staff has determined that members should be allowed to use a special needs trust to protect the interest of an incapacitated child if the probate court acknowledges the special needs trust in a court order related to the child.

XIV. **Staff Reports.**

A. **Quarterly Travel Update for Board, Staff, Preretirement Counselors**. Mr. Berry presented the quarterly travel update for the Board, staff, and preretirement counselors. There was an overall increase in Board expenses, due to Board members attending more conferences in 2011 than in 2010. Total travel expenditures for the Board still compare favorably to 2008 numbers. There was an overall decrease in staff travel expenses, due to the Executive Director having fewer out of town trips and pre-retirement counselors having less overnight travel. There was also a significant decrease in the amount of registration fees for classes in 2011 due to classes that were required in 2010.

XV. **Executive Session to Discuss Executive Director's Performance Evaluation.** Chair, Dr. Abernathy, called the Executive Session of the Board of Trustees to order at 2:01 p.m.

Chair, Dr. Abernathy, reconvened the Board of Trustees meeting at 2:10 p.m.

XVI. **Other Business.**

XVII. **Adjourn.**

Mr. Stubblefield *moved to adjourn* the Board of Trustees Meeting. Mr. Knight *seconded* the *motion*, and the Board *unanimously approved the motion*.

Meeting adjourned at 2:20 p.m.

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