

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

Monday, June 6, 2016

11:30 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
Kelly Davis
Susannah Marshall, designee for Candace Franks
John Ahlen, designee for Andrea Lea
Jim Harris, designee for Dennis Milligan
Robin Nichols
Janet Watson*

Board Members Absent

Kathy Clayton
Johnny Key
Bobby Lester
Deborah Thompson

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

**via teleconference*

ATRS Staff Present

George Hopkins, Executive Director
Gail Bolden, Deputy Director
Shane Benbrook, Internal Audit/Risk Mgmt.
Curtis Carter, Chief Fiscal Officer
Laura Gilson, General Counsel
Rod Graves, Assoc. Dir. of Operations
Wayne Greathouse, Assoc. Dir of investments
Jerry Meyer, Manager, Real Assets
Martha Miller, Staff Attorney
Manju, Manager, Data Processing
Tammy Porter, Executive Assistant
Michael Ray, Dir., Member Services
Clint Rhoden, Director of Operations
Joe Sithong, Software Support Analyst

Guest Present

Donna Morey, ARTA.
David Kizzia, AEA

Consultants Present

Michael Bacine, Franklin Park
PJ Kelly, AHIC (Aon Hewitt)
Chae Hong, AHIC (Aon Hewitt)

- I. **Call to Order/Roll Call.** Mr. Jeff Stubblefield, Chair, called the Board of Trustee meeting to order at 11:35 a.m. Roll call was taken. Ms. Clayton, Mr. Lester, Ms. Thompson and Mr. Key were absent.
- II. **Motion to Excuse Absences.**

Mr. Knight *moved to excuse Ms. Clayton, Mr. Lester, Ms. Thompson, and Mr. Key from the June 6, 2016 Board of Trustees meeting. Mr. Black seconded the motion, and the Board unanimously approved the motion.*

III. Adoption of Agenda

Ms. Nichols *moved for adoption of the Agenda. Mr. Ahlen seconded the motion, and the Board unanimously approved the motion.*

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

V. Approval of Minutes.

A. Approval of April 4, 2016 Minutes.

Dr. Abernathy *moved for approval of the Minutes of the Board of Trustees meeting of April 4, 2016 2016. Mr. Black seconded the motion, and the Board unanimously approved the motion.*

B. Approval of April 21, 2016 Minutes.

Mr. Black *moved for approval of the Minutes of the Board of Trustees meeting of April 21, 2016 2016. Mr. Knight seconded the motion, and the Board unanimously approved the motion.*

VI. Adoption of Interest Rate for T-DROP Accounts for 2016-2017 (June 30, 2017). The ATRS rules state that the Board sets interest rates for active T-DROP accounts for the July 1, 2017, interest accrual on accounts. The rules state that the interest rate shall be 2% less than the ATRS investment rate of return with a maximum of 6% and a minimum of 2%. The investment rate of return for the 12-month period ending March 31, 2016, is used as a gauge. It appears a 2% interest rate on active T-DROP accounts is in order based upon our consultant's evaluation of the ATRS portfolio having an investment return of less than 4% for the 12-month period ending March 31, 2016. However, the Board officially adopts the rate at the June ATRS Board meeting.

Dr. Abernathy *moved to adopt Resolution 2016-19, Adoption of the Interest Rate for T-DROP Accounts for 2016-2017 at 2%. Ms. Bell seconded the motion, and the Board unanimously adopted the resolution.*

- VII. Adoption of Interest Rate for Post 10-Year T-DROP Accounts for 2016-2017 (June 30, 2017).** Like the interest rate for active T-DROP participants, the Board separately sets the interest rate for post 10-year T-DROP accounts of between 4% and 6%. Again, this is the interest rate for the interest applied to post 10-year T-DROP accounts on July 1, 2017. Based upon the investment returns of the ATRS trust fund for the 12-month period ending March 31, 2016, it appears that a post 10-year interest rate of 4% is in order. However, the Board officially adopts the rate at the June ATRS Board meeting.

Mr. Knight *moved to adopt* Resolution 2016-20, Adoption of the Interest Rate for Post 10-Year T-DROP Accounts for 2016-2017 at 4%. Ms. Bell *seconded the motion*, and the Board *unanimously adopted the resolution*.

- VIII. 2016 Board of Trustees Election Results.** ATRS Board and staff, along with the ATRS members congratulated the re-elected Position 2 Trustee, Ms. Janet Watson, and the re-elected Position 9 Trustee, Mr. Lloyd Black. A copy of the certified election results were presented to the Board. The time has passed for any objections or appeals. The final step is that ATRS Board approves a resolution to accept the election results for the results to become official

Dr. Abernathy *moved to adopt* Resolution 2016-21, 2016 Board of Trustee Election Results. Ms. Davis *seconded the motion*, and the Board *unanimously adopted the resolution*.

- IX. Report of Member Interest Waived Under A. C. A. Section 24-7-205.** Mr. Hopkins presented the member interest amount waived report. ATRS waives interest for members when there is a dispute between ATRS and the member as to whether ATRS made a mistake or otherwise did not do all that was required on the member's account. Since ATRS has implemented the actuarial cost method for the purchase of service credit, interest waived is slowly disappearing, as well as the number of members who purchase service credit. **No member interest was waived** this reporting period.
- X. Report of Employer Interest and Penalties Waived Under A. C. A. Sec. 24-7-411.** Mr. Hopkins presented the employer interest and penalties waived report. ATRS may also waive employer interest and penalties when reports or payments are late or have issues due to a new bookkeeper, inclement weather, sickness and other situations that justify a waiver. Two (2) employer penalties and interest was waived for this reporting period for a total amount of **\$900.00**.
- XI. GASB Reports.** The ATRS actuaries and the Division of Legislative Audit have begun in 2015 preparing annual reports required by the Governmental

Accounting Standards Board (GASB) Statement No. 68 "Accounting and Financial Reporting for Pensions." These reports allocate certain pension amounts to participating employers based on the employers' proportionate share of contributions received for the previous fiscal year. Employers use this information as a footnote in their financial statements as required by GASB 68. ATRS would like a motion from the Board to review and file the reports.

Mr. Harris moved to approve the GASB Report After Legislative Audit Review. Ms. Nichols seconded the motion, and the Board unanimously approved the motion.

XII. Manifest Injustice Report. The Manifest Injustice Committee reviewed three cases. One claim was not found to be a manifest injustice. The second claim was where a cafeteria worker was given erroneous information by the school district that she had complete termination separation period and was called back to work by the school. A \$9,000 adjustment was made to her account after consultation with the Board chairman. The final claim is an action item **in Item XII below**. A report has been provided to you in the Board packet on the two claims. The rule on Manifest Injustice requires executive director to report to the ATRS Board on Manifest Injustice claims at least two times per year. This is the first report of 2016. If the ATRS Trustees would like a different format or reporting process, just let ATRS staff know.

XIII. Board Review of Manifest Injustice Finding.

A. Yolanda Collins. The manifest injustice claim for this member was submitted by the executive director to the Manifest Injustice Committee. The basis for the claim was discovered by executive staff during her appeal of a staff determination that found her ineligible for ATRS disability due to being inactive at the time she sought to file a disability application. During the appeal research, unique circumstances surrounding her member appeal were discovered by executive staff. Ms. Collins worked for an ATRS covered employer during a time period of 1995 to 2001. During that time, Ms. Collins earned 5.00 years of service credit. Beginning in 2007, Ms. Collins was employed by the Arkansas Department of Health, and became a member of the Arkansas Public Employees Retirement System (APERS), a reciprocal system to ATRS. Ms. Collins worked in that position until the latter months of 2013.

Ms Collins had an major injury due to an automobile accident in 2013, and began seeking disability relief from ATRS, APERS, and the Social Security Administration. As part of Ms. Collins' inquiry to seek disability retirement, she contacted ATRS in **April 2014** to inquire about the possibility of applying for disability retirement. There is a note in the ATRS membership file documenting the telephone call, and the staff member's response to Ms. Collins. The ATRS staff member that took the telephone call incorrectly informed Ms. Collins that she was not eligible to apply for ATRS disability retirement since she last worked for an ATRS employer in **2001**. In actuality, Ms. Collins had five actual years of ATRS service credit, was considered active due to being active in **APERS**, a reciprocal retirement system, and was eligible to apply for ATRS disability retirement in April of 2014, when she called.

If a reciprocal member, like Ms. Collins, is "active" in the reciprocal system, then ATRS also treats the member as "active" in ATRS through reciprocity. This application of active treatment extends to all types of ATRS benefits. The ATRS staff member failed to consider this reciprocal application of active status when informing Ms. Collins that she was not eligible to apply for ATRS disability benefits because she was not active in ATRS.

In February 2016, Ms. Collins contacted ATRS again to inquire about disability retirement. She had been awarded Social Security Disability status in February 2016, and APERS had begun paying her disability benefits in May 2016. In a staff determination letter to Ms. Collins, she was informed that although ATRS applies APERS active status to the active status requirements for ATRS disability retirement, she was no longer considered active at APERS because she last earned service credit during the 2013-2014 year. The reciprocal service extended her active status to June 30, 2015. Upon receiving the staff determination letter, Ms. Collins appealed the staff determination to the executive director for review.

During the executive staff review process (Gail Bolden assists in an extensive review of the file in every appeal), ATRS executive staff discovered the erroneous information (the erroneous position that the member was not active for ATRS disability purposes) given to Ms. Collins in April 2014. Under the ATRS Rules, only the ATRS Board can extend a filing deadline, such as the deadline to file for disability. The executive director is not allowed to waive a deadline, but can request the ATRS Board to consider extending the filing deadline. I submitted a manifest injustice claim on behalf of the member to the

ATRS Manifest Injustice Committee for consideration. The committee found that the facts within the claim constituted a manifest injustice, The proposed remedy by the committee was that the member should be allowed to apply for disability retirement. The committee also recommended that, if eligible for disability, the disability benefits should begin as if Ms. Collins had filed for benefits immediately after her initial inquiry to ATRS about disability retirement in April 2014.

The ATRS Manifest Injustice Committee and ATRS executive staff recommend that the Board extend the deadline for Ms. Collins to file for disability retirement. I also recommend that ATRS allow her to file for disability through July 31, 2016. If she files and is found to be disabled, executive staff recommends that the ATRS Board allow benefit payments to be paid retroactively as if the application had been filed on the date of her inquiry in April 2014

Mr. Knight *moved to approve the Recommendation of the Manifest Injustice Committee to extend the deadline for Ms. Collins to file for disability retirement. Mr. Black seconded the motion, and the Board unanimously approved the motion.*

XIV. Member Appeal Update

- A. Tamara Gullett.** This appeal was before the Board of Trustees for consideration. Mr. Hopkins reported that the member has withdrawn her appeal at this time.

XV. Audit Committee Report. Ms. Kelly Davis, Chair, gave a report on the Audit Committee meeting.

- A. Internal Audit Report – Implementation of Legislation Enacted by the 90th General Assembly.** Mr. Shane Benbrook presented the Audit Report on Implementation of Legislation by the 90th General Assembly. The objective of the audit was to assess ATRS implementation of the new laws enacted by the 90th General Assembly by reviewing policies and procedures to verify they were properly updated to conform to the new provisions of law. Internal Auditors reviewed the new laws, met with ATRS staff responsible for implementing necessary changes, performed tests of member and

employer records, and reviewed documentation to determine the following:

- If a policy change was required, the updated policy was approved and corresponding procedures were also updated;
- If changes to computer programming were required, a ticket was created and completed for the change;
- Necessary changes to forms or form letters were completed; and
- Employers and members were notified of changes as appropriate.

Based upon Internal Audit's review, it is the opinion of the Internal Audit Department that ATRS staff properly implemented legislation enacted by the 90th General Assembly.

Executive Director Hopkins informed the Committee that Ms. Brenda West was on temporary leave.

- B. FY2016 Internal Audit Follow Up Report: Membership Data.** Mr. Shane Benbrook presented the follow up report to the audit of ATRS Membership Data. The audit revealed two members were missing a quarter of a year on their contributory service credit due to timing of the system's calculations. Also, it was discovered that current year interest on active and inactive member contributions were not included in the information sent to the actuary. Both issues were addressed by the Data Processing Department and have been resolved.
- C 2016 Risk Assessment.** Mr. Shane Benbrook presented the 2016 Risk Assessment. DF&A requires each state agency to perform a risk assessment every 2 years. Managers and supervisors identify areas of risk in their departments and determine what controls are in place to mitigate the risk. This information is reviewed and compiled by the Internal Audit Department. Internal Audit then enters the information into the DFA reporting and tracking tool. The risk assessment allows DFA to address areas where assets may be at risk statewide. It also serves as a valuable tool for ATRS Administration and the Internal Audit Department in identifying areas within ATRS where the system of internal control needs review.
- D. Internal Audit Charter.** The International Standards for the Professional Practice of Internal Auditing (Standards) require audit

organizations to establish an audit charter that formally defines the organization's purpose, authority, and responsibility. The ATRS Internal Audit Charter presented for approval establishes the Internal Audit position within ATRS, including the Internal Audit Director's functional reporting relationship with the Board of Trustees; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Mr. Hopkins reported that the Internal Audit works separately from him, but he occasionally calls them in to work on projects. Mr. Hopkins only approves leave and he does not oversee their work. Currently, Mr. Hopkins handles the evaluation of Ms. West. Mr. Hopkins did ask the Committee if the Committee should be doing Ms. West evaluation. Mr. Quattlebaum reported that Mr. Hopkins could handle the evaluation, but the Committee needs to give approval.

Ms. Davis moved to approve the Internal Audit Charter as presented. The Board unanimously approved the Motion.

The Standards and the Charter also require Internal Audit staff members to submit Conflict of Interest Statements and Code of Ethics Acknowledgments annually. Those signed documents are included with the Charter for approval by the Audit Committee.

Ms. Davis moved to approve the Conflict of Interest Statements. The Board unanimously approved the Motion.

Ms. Davis moved to approve the Code of Ethics Acknowledgement Statements. The Board unanimously approved the Motion.

- E. 2017 Internal Audit Plan.** Ms. Mitzi Ferguson presented the 2017 Internal Audit Plan. As required by the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors (IIA), and by Arkansas Teacher Retirement Systems (ATRS) Internal Audit Charter, the Internal Audit Plan for the Internal Audit Fiscal Year 2017 was presented to the Committee. Projects were identified for this audit plan by using the ATRS risk assessment. As ATRS continues to grow in terms of responsibilities, assets, and membership, there are areas that require regular reviews to ascertain whether the system continues to operate in an effective and efficient,

risk-controlled manner. Choices were made in determining which audits to perform first by determining which areas posed greater risks for the system. We have selected areas of processes for review where failure of the system to adequately perform could have serious consequences for ATRS, its members and stakeholders, and the Board.

FY2016 Summary of Work Completed was also presented.

Ms. Davis moved to approve the FY2016 Summary of Work Completed. The Board unanimously approved the Motion.

- F. Other Business.** Mr. Shane Benbrook reported that ATRS Internal Audit will be hosting the APPFA conference in Little Rock for the first time. The conference will be near the first part of May 2017. Anywhere from 55-75 internal auditors from around the United States and Canada will be attending. Some of the speakers expected at the conference are: George Hopkins, ATRS Executive Director; Gail Stone, APERS Director; Arkansas Hall of Fame member and NFL referee, Walt Coleman; P.J. Kelly from Aon Hewitt; and Ricky Quattlebaum from the Department of Finance and Administration – Internal Audit.

XVI. Investment Committee Report. Ms. Nichols, Chair, gave a report on the Investment Committee meeting.

A. Private Equity Consultant Report – Franklin Park

- 1. Private Equity Portfolio Review for the Quarter Ended December 31, 2015.** Michael Bacine of Franklin Park presented the private equity report for the quarter ended December 31, 2015. ATRS Legacy Portfolio is still in liquidating stage and has a remaining value of 2.7% with a total IRR of 9.2%. CSFB Portfolio is also liquidating and will continue to see distributions. CSFB has a remaining value of 22.4% with a net IRR of 8.6%. The Post 2006 Portfolio represents two-thirds of ATRS portfolio and will continue to grow as more commitments are made to capital. The Post 2006 Portfolio has a net IRR of 15.0%. The total fund had a net IRR of 9.9% for the quarter ended December 31, 2015.

2. **Recommendation to Commit up to \$20 Million Dollars in Altaris Constellation Partners, LP, a Private Equity Buyout Fund Specializing in Small to Middle Market Health Care Companies.** Michael Bacine presented the recommendation of Altaris to the Committee. Altaris was formed in 2002 with sponsorship from AIG. Altaris is located in New York. The firm is owned by Michael Kluger, Daniel Tully and George Aitken-Davies (principals) who have an average of over 20 years of experience in the private equity industry and 13 years with Altaris. This fund's investment plan is to invest in transactions that require equity in excess of what the general partner deems appropriate for the current fund (Fund III or the "Core Fund"). The principals view the general partner's ability to win larger deals as a natural progression of their level of activity and the extensive sub-sector networks they have built since 2002. Making larger commitments would broaden the potential investment universe and would also allow the general partner to acquire all of the equity in certain transactions and avoid syndicating equity to third parties (co-investments) and other private equity managers. Said another way, the fund sees the success that ATRS and others have had with making co-investments and want to have a fund that benefits from this same space for their own funds.

The fund will primarily target U.S. and European healthcare companies with attributes such as intellectual property, defensible market positions, limited government reimbursement and transformational business models. In particular, the fund will focus on corporate carve-outs, leveraged buyouts and growth equity investments in pharmaceutical, medical device, and information and technology companies. The firm has generated attractive returns with an average net IRR greater than 20% in its previous three funds. Both Franklin Park and ATRS staff recommend a commitment of up to \$20 million dollars in Altaris Constellation Partners, L.P.

Mr. Hopkins confirmed staff supports recommendation.

Ms. Nichols *moved to adopt* Resolution 2016-22, to Commit up to \$20 Million Dollars in Altaris Constellation Partners, LP, a Private Equity Buyout Fund Specializing in Small to Middle Market Health Care Companies. The Board *unanimously adopted the Resolution.*

3. **Recommendation to Commit up to \$35 Million Dollars in Bison Capital Partners V, L.P., a Private Equity Debt and Equity Fund Focused on Hybrid Debt and Equity Investments in Small to Middle Market Companies.** Michael Bacine presented the recommendation to the Committee. Bison Capital Partners V, L.P. is a Private Equity Debt and Equity Fund. The fund will focus on making hybrid debt/equity investments in small and lower middle market U.S. companies primarily in the business services, healthcare services, technology-enabled businesses, and logistics and distribution sectors. Investments will typically be non-control junior capital and structured as a combination of senior and subordinated debt and preferred equity securities, with existing owners retaining a control stake. Investments will generally be structured with a yield of 8-15%, including cash interest and payment-in-kind (PIK) interest. Capital will be used to support growth initiatives, acquisitions and/or recapitalization of non-active shareholders. This type of investment has a slightly lower risk/return profile than other types of private equity due to the debt component. This type of fund is a great diversifier. The firm has generated strong returns in its previous four funds with an average net IRR of approximately 13%. Both Franklin Park and ATRS staff recommend a commitment of up to \$35 million in Bison Capital Partners V, L.P.

Mr. Hopkins confirmed staff supports recommendation.

Ms. Nichols *moved to adopt Resolution 2016-23, to Commit up to \$35 Million Dollars in Bison Capital Partners V, L.P., a Private Equity Debt and Equity Fund Focused on Hybrid Debt and Equity Investments in Small to Middle Market Companies. The Board unanimously adopted the Resolution.*

B. Investment Update and Arkansas Related Update.

1. List of Fund Closings.
 - a. **Global Infrastructure Partners III, LLC, a Real Assets Infrastructure Fund Specializing in Core Plus Energy, Transport, and Water/Waste Sectors, the Board Authorized Commitment of up to \$50 Million Dollars on February 1, 2016, was Accepted and Closed on April 15,**

2016. The ATRS full commitment of \$50 million dollars was negotiated, accepted, and closed on April 15, 2016.

- b. **Aeolus Catastrophe Keystone PF Fund, LP**, an Opportunistic/Alternative Reinsurance Fund Specializing in Property Catastrophe Insurance Coverage, the Board Authorized Commitment of up to an Additional \$37 Million Dollars on April 4, 2016, was Accepted and Closed on May 24, 2016. The ATRS full commitment of an additional \$37 million dollars was negotiated, accepted, and closed on May 24, 2016.
- c. **Thoma Bravo XII, L.P.**, a Private Equity Buyout Fund that Invests in Middle to Large Market Software Companies, the Board Authorized Commitment of up to \$30 Million Dollars on April 4, 2016, with Imminent Need was Accepted and Closed on April 27, 2016. The ATRS full commitment of \$30 million dollars was negotiated, accepted, and closed on April 27, 2016.

2. Transitions.

- a. **BlackRock U.S. Equity Market Fund A**, a Passive U. S. Equity Index Fund, the Board Authorized Transition out of the BlackRock U.S. Equity Market Fund A on April 4, 2016, was Completed on April 13, 2016. The Board approved transition of approximately \$2 million dollars out of the BlackRock U.S. Equity Market Fund A was completed on April 13, 2016.
- b. **Intra-Allocation Rebalancing of the Equity Portfolio** was Completed on May 6, 2016, by Purchasing an Additional Amount of Approximately \$25.3 Million Dollars of Pershing Square Holdings, the Publicly Traded Stock Based on the ATRS Activist Manager, Pershing Square International, LTD at a Net Cost of \$30 Dollars. ATRS has had a successful allocation to activist managers since 2008. Activist managers try to purchase large enough numbers of a public company's shares to obtain seats on the company's board with the goal of making changes designed to increase the value of the company. The ATRS allocation to activist managers has declined in recent years due to the unwinding of several activist

manager funds such as Lincoln Vale and Relational Investors. Based on recommendation from Aon Hewitt Investment Consulting and after positive notice to the Board Chair, the equity allocation was recently rebalanced by purchasing approximately \$25.3 million dollars of additional Pershing Square Holdings (PSH) stock in order to take advantage of market conditions of the stock in Pershing Square and to rebalance the activist manager allocation.

ATRS invested with Pershing Square in July 2008. Pershing Square invests in large US companies that are underperforming and provides advice to improve earnings and status. In October 2012 the Board approved restructuring this investment into two investments both managed by Pershing Square. One of these approved investments, Pershing Square International LTD (PSI), is a closed end fund with limited rights of withdrawal. The limitations provide the fund manager with greater opportunity for longer and more specialized investments due to reduced liquidity concerns in the fund. The other investment approved in October 2012, PSH, was a fund designed to provide liquidity by being converted to a closed end fund that is publicly traded through an Initial Public Offering (IPO). The IPO occurred in October 2014 and shares are now publicly traded. Essentially PSH is the publicly traded version of PSI with PSH providing more flexibility to ATRS when rebalancing, making additional contributions, or redemptions.

The net asset value (NAV) or price of PSH shares is composed of the price of the underlying stocks that the fund owns. These underlying stocks have their own values that determine the overall NAV or calculated value of PSH. Since PSH is publicly traded the value at which the shares of PSH trade fluctuates on the open market like other publicly traded stocks and bonds and may be more or less than the NAV or calculated value of the underlying assets. At times the difference between the NAV of the underlying assets and the price which PSH is publicly traded may offer either a discount or premium to NAV. This means that ATRS can see, on a daily basis, if

the price of Pershing Square is cheaper than the underlying stocks that make up Pershing Square.

When the publicly traded shares of PSH are trading at a price below the calculated value of the underlying investments, the shares are trading at a discount to NAV. When the publicly traded value is above the underlying NAV, the shares are trading at a premium to NAV. Sometimes these differences can be significant and offer ATRS an opportunity to benefit from the pricing difference by buying more shares of PSH or selling shares of PSH depending on the discount or premium to NAV. For example if the NAV of the underlying assets is valued at \$100 dollars and shares of PSH are trading at \$90 dollars, the shares are trading at a 10% discount.

In April 2016 PSH stock was trading at a significant discount to the underlying investments held by the fund and offered ATRS an opportunity to increase the allocation to Pershing Square and the activist manager category through the publicly traded PSH. As with other publicly traded investments, investors must be aware of trading volumes and news that can inflate a stock's price prior to the investor making a purchase. The amount of stock to be traded, daily trading volume, and other factors can sometimes produce millions of dollars in costs to execute a transaction. One way to avoid these potential costs is to enlist a transition manager that can help with the timely execution of the transaction. Transition managers may also know of a potential seller that can be paired with a potential buyer to execute the trade in an efficient manner. Both the buyer and seller want to avoid transactions costs and commissions. Sometimes the ability to pair a buyer and seller is like hitting 4 grand slams in one game.

Aon Hewitt Investment Consulting (AHIC) identified BlackRock Institutional Trust (BlackRock), a Board approved transition manager, as having a potential seller of PSH and recommended ATRS use BlackRock to facilitate the rebalancing. By using the existing seller ATRS was able to complete the rebalancing purchase of approximately \$25.3 million dollars over two equal phases with half the position purchased on April 29,

2016, and the rest on May 6, 2016. Without the benefits of this existing seller, BlackRock estimates the rebalancing **may have cost between \$1.25 and \$2.5 million dollars** and taken several weeks. The result using the existing seller was a rebalancing purchase of approximately \$25.3 million dollars of PSH at a net cost of \$30 dollars.

C. General Investment Consultant Update – Aon Hewitt Investment Consulting.

- 1. Performance Report for the Month Ended April 30, 2016.**
P.J. Kelly of Aon Hewitt Investment Consulting presented the performance report for the month ended April 30, 2016. The ATRS fund had a market value of approximately \$14.4 billion dollars. The total fund had a return of 8.3% since inception, underperforming its benchmark of 8.4%.

D. Real Assets Investment Consultant Report – AON Hewitt Investment Consulting.

- 1. Performance Report for Quarter Ended December 31, 2015.**
Chae Hong, of Aon Hewitt Investment Consulting presented the performance report for the quarter ended December 31, 2015. Through the fourth quarter of 2015, NCREIF's NPI registered at 2.9% and NFI-ODCE (net) returned 3.1%. The NPI returned showed a 20 bps decrease quarter over quarter while the NFI-ODCE showed a 30 bps decrease. NCREIF Timberland Index returned 1.9% for the quarter and 5.0% for trailing one year. NCREIF Farm Index gained 4.3% for the fourth quarter, an increase of 180 bps, while posting a 10.4% return for the trailing one year, a decrease of 230 bps over the third quarter.
- 2. Recommendation to Commit up to \$50 Million Dollars in UBS Trumbull Property Income Fund, LP, a Core Real Estate Debt Fund Focused on Hybrid Debt and Equity Investments in Income Generating Properties.**
Chae Hong of Aon Hewitt Investment Consulting presented the Recommendation of USB Trumbull Property Income Fund, LP to the Committee. UBS Trumbull Property Income Fund, LP (TPI) was formed in March 1981 to invest in commercial real estate debt. TPI is an open end, diversified core real estate debt fund that targets participating mortgages. The fund's strategy is to build an actively managed portfolio of income-oriented real estate investments that have hybrid debt and equity return

characteristics. It seeks to provide attractive returns while limiting downside risks through a combination of fixed income, participation in cash flow, and equity upside. TPI's investment objective is to provide a 5% real return on a three and five-year basis. ATRS invested in the UBS Trumbull Property Fund in 2006. This is an open end core real estate fund with a net IRR of 6.2% since inception. ATRS is also invested in the UBS Agrivest Core Farmland Fund. ATRS began funding this investment in April 2015 and completed the commitment in January 2016. The net IRR for the short time that ATRS has been in the fund is 2.6%.

The two-person portfolio management team is led by Gary Gowdy, Managing Director, who has 38 years of real estate industry experience, of which more than 20 have been with UBS Realty Investors and the predecessor firm. The TPI team has demonstrated a successful history by producing a net 10 year IRR of 7.4% and a net IRR of 8.8% since inception. Both Aon Hewitt Investment Consulting and ATRS staff recommend an investment in UBS Trumbull Property Income Fund, LP with a commitment of up to \$50 million dollars.

Mr. Hopkins confirmed staff supports the recommendation.

Ms. Nichols *moved to adopt* Resolution 2016-24, to Commit up to \$50 Million Dollars in UBS Trumbull Property Income Fund, LP, a Core Real Estate Debt Fund Focused on Hybrid Debt and Equity Investments in Income Generating Properties. The Board *unanimously adopted the Resolution.*

3. **Recommendation to Commit up to \$30 Million Dollars in LaSalle Asia Opportunity Fund V, L.P., an Opportunistic Real Estate Fund Focused on Both Debt and Equity Investments in Asia.** Chae Hong of Aon Hewitt Investment Consulting presented the Recommendation of LaSalle Asia Opportunity Fund V, L.P. to the committee. LaSalle Investment Management was formed in 1996 to focus on commercial real estate investments. The LaSalle Asia Opportunity real estate series platform began in 2001. LaSalle Asia Opportunity Fund V, L.P. is a closed end fund. ATRS invested in the LaSalle Asia Opportunity Fund IV in June 2014 and to date has earned a net IRR of 64% so far. The objective of the LaSalle Asia Opportunity Fund V, L.P. (LAOF V) is to provide a net IRR of

18% by making debt or equity investments in office, retail, residential, warehousing, hotels, and other commercial properties primarily in Asia. Assets located Japan, Australia and China are expected to comprise the bulk of the portfolio. Mark Montanus and Mark Gabbay return as Fund Manager & CEO respectively and the same strong support team remains intact for Fund V. Both Aon Hewitt Investment Consulting and ATRS staff recommend an investment in LaSalle Asia Opportunity Fund V, L.P. with a commitment of up to \$30 million dollars.

Mr. Hopkins confirmed staff supports the recommendation.

Ms. Nichols *moved to adopt Resolution 2016-25, to Commit up to \$30 Million Dollars in LaSalle Asia Opportunity Fund V, L.P., an Opportunistic Real Estate Fund Focused on Both Debt and Equity Investments in Asia. The Board *unanimously adopted the Resolution.**

XVII. Operations Committee Report. Dr. Richard Abernathy, Vice Chair, gave a report on the Operations Committee meeting.

A. Open Forum for Potential Rule or Law Changes by Committee Members and Board Members in Attendance.

1. **Open Forum.** The Committee discussed potential Outsourcing legislation for the 2017 Legislative Session. Dr. Abernathy suggested that the Committee move forward with this issue for the next session. Mr. Hopkins told the Committee there were three (3) options to do. The first option is to ban outsourcing, which the Committee agrees is not an option at this point. The second option is the concept that people would still be part of our system and potential employees of contractor would still participate in our system, causing a shift in responsibility from school districts to employers. The third option is to implement over time some type of surcharge that would apply to imbedded employees at school district in terms of their salary, not contract, that would help offset losses that are incurred by retirement systems due to outsourcing.

B. Potential 2017 Legislation.

1. **For Committee Input.**

- a. **Marriage Option Eligibility for Survivor Benefits.** ATRS survivor benefits law provides a lifetime benefit to a surviving spouse of a deceased active or T-DROP member if the marriage occurred two-years prior to the member's death. At the last Operations Committee meeting, the committee discussed the fact that all other marriage option beneficiary selections have a one year marriage requirement such as at the time of retirement or marriage after retirement. A suggestion was made to leave the two-year marriage requirement in place. The Operations Committee took no action at this time.

- b. **Spousal Benefit Rights Waived for Survivor Benefits.** If active or T-DROP members are married for two years preceding the member's death, the surviving spouse is **automatically** entitled to a lifetime benefit, even if the member has chosen a different person as the member's residual beneficiary (for instance a child or parent). Current law supersedes the member's designation and the spouse receives the lifetime benefit. The discussion at the last Operations Committee meeting indicated a potential change to leave the member in control of designating a residual beneficiary without an automatic override for spousal benefits. As a reminder of the discussion, if a survivor of an active or T-DROP participant has been married for 2 years, the right of the surviving spouse supersedes the beneficiary designation that may be to the deceased member's children from a prior marriage and would provide the surviving spouse with a lifetime Option A benefit. One potential change would be to allow the member to override the law on spousal priority by having the form allow the override to the beneficiaries if chosen very specifically by the member to do so. The Operations Committee asked staff to begin working on potential legislation concerning this matter.

- c. **Settlement Agreements Designed to Address Previous Benefit Underpayments in Claims of Wrongful Termination.** ATRS staff has been consulted recently in structuring two very substantial settlement agreements between covered employers and employee-members. One attorney wanted to purchase the time

value of lost additional salary due to a wrongful termination. For example, the member was passed over for a \$20,000 promotion but continued working at the lower salary. Later, the employer recognizes that a problem exists with the promotion decision due to litigation. ATRS law does not allow for a calculation to add salary to credited service, but it would be very easy to do so using actuarial factor tables for the cost of an annual annuity. ATRS can use T-DROP annuity factors to "back into" the cost. This would give employers and members the benefit of having this choice available, as well as the current collection of employer contributions on a settlement payout. ATRS staff would like to have the input of the Operations Committee to see if this is an option we would consider providing. An example: A member sues for failure to promote. The parties agree that the member should have been paid \$20,000 extra for the last 3 years. ATRS can calculate the amount the member's monthly annuity would increase with current service and then see how much money would be needed to "buy" that amount of additional benefit using the T-DROP annuity factors. In this example, the member is 52 years old. If the calculation shows the member would have a \$500 per month higher benefit, ATRS can easily calculate the benefit. The amount required to provide a \$500 monthly annuity to an age 52 member is \$86,844. Instead of collecting employer contributions on a settlement amount of \$100,000 ($\$100,000 * 14\% = \$14,000$) or \$200,000 ($\$28,000$), ATRS could collect the \$86,844 and pay the member an additional \$500 monthly benefit upon retirement. The cost is neutral (perhaps a small gain to ATRS) on this potential change and may help both members and employers. The Operations Committee asked staff to begin working on potential legislation concerning this matter.

- d. **Clarification of Act 1211 of 2009 – Partial Equity Ownership Investment to Include a Loan or Similar Investment.** The 2009 Act allowed partial equity ownership agreements to have a special review process by the Office of State Procurement (OSP) and the Legislative Council. Prior to that time, there was no clear review process for long term closed end investments that had a 10 to 15 year holding period. Because only

retirement trust funds are utilized, the partial equity ownership agreements are not subject to a limitation on duration (usually a maximum of 7 years) of the agreement or an annual renewal clause like most state contracts. Additionally, this Act created the imminent need review of agreements that must close quickly due to the nature of some private equity investments and quick closing periods. The highest performing private equity deals tend to move quickly from creation to close, and the traditional review process precluded ATRS from participating in many investments because the agreements were not approved quickly enough by OSP and Legislative Council. The clarification of this section of the law would include a direct purchase of an investment, or a loan such as the recent Arkansas Development Finance Authority loans. This would not be a material change to this section of the law. Staff recommended this potential change in order to take advantage of investment proposals that are not compatible with the regular state contract review process while continuing to have transparency with the General Assembly. The Operations Committee asked staff to begin working on potential legislation concerning this matter.

- e. **Potential T-DROP/DROP Changes to Encourage ATRS Members to Postpone Retirement if the Member enters T-DROP and DROP while employed at an ATRS Employer and can remain in T-DROP 10 years.** Currently, an ATRS member can participate in T-DROP a full 10 years by beginning T-DROP at an ATRS employer, even if the member participates in a shorter DROP plan of another system. The member faces a big disincentive to remain in T-DROP and continue working at the ATRS employer after the end of year seven (7). After seven (7) years, the DROP balance at the reciprocal system is frozen, without interest, until the member retires from ATRS. Plus, at APERS, if the member does not retire at the end of year ten (10), the DROP account is forfeited. This means many will retire and draw a benefit three (3) or more years earlier than intended, thus removing talent from the public schools and costing money to the systems. Alternatives to this early out incentive can be developed but would require

cooperation from other systems. The Operations Committee asked staff to begin working on potential legislation concerning this matter.

2. Pending Committee Approval

a. Disability Retirement to Return to Work Options. ATRS staff presented three (3) proposed draft legislations for disability return to work options for consideration by the Operations Committee.

1. **Return to Active Covered Employment;**
2. **Return to Limited Covered Employment; and**
3. **Return to Covered Employment Using a Disability Exemption.**

Dr. Abernathy *moved* to *approve* draft legislation for Disability Retirement to Return To Active Covered Employment. Mr. Stubblefield *seconded* the *motion* and the Committee *unanimously approved the motion*.

C. Reduction in Paper Checks produced by State Auditor's Office. No action was taken on this matter at this time.

D. Mailing of Educational Association Materials with Final Retirement Correspondence. ATRS had a practice of including ARTA and AEA membership enrollment packets to members, upon retirement, with mailing packets of final ATRS retirement documents. This has been done over many years as a courtesy to the organizations since both can have legislatively approved membership deductions from the monthly ATRS benefit payments. Over the years, the ARTA organization stopped supplying enrollment packets to ATRS, and instead began contacting retirees directly. The AEA membership enrollment packets are still included with the final mailing of ATRS retirement documents. There was never a policy in place, just an informal arrangement.

ATRS has recently been contacted by another Arkansas educational organization asking to include their membership enrollment packets with the ATRS final retirement documents. The Operations Committee

instructed staff to decline for mailing additional educational materials from private sources with ATRS retirement applications.

XVIII. Staff Reports.

- A. Medical Committee Reports.** Michael Ray presented the Medical Committee reports. A total of twenty seven (27) disability applications were received, twenty six (26) were approved for disability benefits, and one (1) needed more information.

Ms. Nichols moved to approve the Medical Committee Reports. Dr. Abernathy seconded the motion, and the Board unanimously approved the motion.

XV. Other Business: None

XVII. Adjourn.

Dr. Abernathy moved to adjourn the Board Meeting. Ms. Nichols seconded the motion, and the board unanimously approved the motion.

Meeting adjourned at 12:06 p.m.

Clint Rhoden,
Executive Director

Mr. Jeff Stubblefield, Chair
Board of Trustees

Tammy Porter,
Recorder

Date Approved