

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

**Monday, October 3, 2016
11:00 a.m.
1400 West Third Street
Little Rock, AR 72201**

ATTENDEES

Board Members Present

Jeff Stubblefield, Chair
Danny Knight, Vice Chair
Dr. Richard Abernathy
Anita Bell
Lloyd Black
Kathy Clayton
Kelly Davis*
Luther Guinn, designee for Candace Franks
Hon. Andrea Lea*
Bobby Lester
Robin Nichols
Deborah Thompson
Janet Watson

Board Members Absent

Hon. Dennis Milligan
Johnny Key

ATRS Staff Present

George Hopkins, Executive Director
Gail Bolden, Deputy Director
Shane Benbrook, Internal Audit/Risk Mgmt.
Curtis Carter, Chief Fiscal Officer
Mitzi Ferguson, Internal Audit/Risk Mgmt.
Vicky Fowler, Dir. Human Resources
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
Misty Yant, Manager, Reporting

Guest Present

Chris Caldwell, Div. of Legislative Audit
Emily Tucker, Div. of Legislative Audit
Donna Morey, ARTA
David Bell, Governor's Office

**via teleconference*

- I. **Call to Order/Roll Call.** Mr. Jeff Stubblefield, Chair, called the Board of Trustee meeting to order at 11:00 a.m. Voice roll call was taken by Deputy Director, Gail Bolden. Mr. Key and Mr. Milligan were absent.

- II. **Motion to Excuse Absences.**

Ms. Nichols moved to excuse Mr. Key and Honorable Milligan from the October 3, 2016 Board of Trustees meeting. Ms. Bell seconded the motion, and the Board unanimously approved the motion.

III. Adoption of Agenda

Dr. Abernathy moved for adoption of the Agenda. Mr. Lester 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 June 6, 2016 Minutes.

Dr. Abernathy moved for approval of the Minutes of the Board of Trustees meeting of June 6, 2016. Ms. Nichols seconded the motion, and the Board unanimously approved the motion.

B. Approval of July 19, 2016 Minutes.

Ms. Clayton moved for approval of the Minutes of the Board of Trustees meeting of July 19, 2016. Mr. Black seconded the motion, and the Board unanimously approved the motion.

VI. 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. A total of \$408.90 member interest was waived from this reporting period.

VII 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. Five (5) employer penalties and interest were waived for this reporting period for a total amount of **\$1,519.87**.

VIII. Member Appeals.

- A. Minnie Ivy.** This appeal was presented to Board of Trustees for consideration. A proposed Order of the hearing officer was presented to the Board. Under Rule 13, the Board has the final authority to accept the Proposed Order, reject the Proposed Order, or accept the Proposed Order as modified by the Board. In addition to the Board making its own findings of fact and conclusions of law, if the Board rejects the Proposed Order in whole or in part, they may remand the matter back to the Hearing Officer for reconsideration.

At the time of her death on August 19, 2014, Minnie Ivy was a retired member of ATRS, and had previously submitted a lump sum death benefit designation naming Ricky L. Ivy as the primary beneficiary. The beneficiary designation form, which was received by ATRS on July 9, 2008, indicated that it was signed by Ms. Ivy on September 20, 2007, but not notarized until October 12, 2007. Upon her death, a staff determination letter was sent on August 19, 2015, to both Ms. Ivy's sons, Dan and Rickey, stating that Ms. Ivy's beneficiary designation form was not valid, and that Rickey Ivy's request for payment of the lump sum death benefit would not be honored. Both sons appealed the staff determination. The Executive Director reviewed the matter and reversed the staff finding. Specifically, the Executive Director found that Ms. Ivy's beneficiary designation form was valid under the ATRS five year look-back law, and that the \$10,000 lump sum death benefit should be paid to Ricky Ivy.

Dan Ivy appealed. The Hearing Officer affirmed the Executive Director Review. The look-back period ended on June 30, 2013, and no challenge to the form's validity could be pursued beyond that date, absent a showing of intentional nondisclosure, fraud, misrepresentation or criminal act. The Hearing Office found that no evidence of any exception to the look-back period could be found in the record nor did Dan Ivy offer such evidence during the hearing.

No one was in attendance on behalf of Mr. Rickey Ivy or Mr. Dan Ivy at the Board meeting.

Mr. Knight moved to approve the Proposed Order and Findings of Fact of the Hearing Officer. Mr. Black seconded that Motion and The Board unanimously approved the Motion.

- B. Betty Fuller.** This appeal was presented to the Board of Trustees for consideration. A proposed Order of the hearing officer was presented to the Board. Under Rule 13, the Board has the final authority to accept the Proposed Order, reject the Proposed Order, or accept the Proposed Order as modified by the Board. In addition to the Board finding its own findings of fact and conclusions of law, if the Board rejects the Proposed Order in whole or in part, they may remand the matter back to the Hearing Officer for reconsideration.

Betty Fuller is an active member of ATRS who is contemplating retirement and recently discovered an error in the number of years of credited service. Due to a reporting error by her covered employer during the 2004-2005 academic year, she was credited with a fractional 0.75 year of service credit instead of a full year even though she worked a sufficient number of days to be credited with a full year.

ATRS staff made a determination that the five year look-back law prevented the correction of the error in her years of credited service. That decision was affirmed by the Executive Director on February 1, 2016. On appeal, counsel for Ms. Fuller argued that the five year look-back law could not be applied retroactively and the five year bar did not become fully effective until July 1, 2016. After a hearing, the decision was affirmed again by the Hearing Officer who found that the five year look-back law barred the correction of the error.

On August 5, 2016, ATRS was notified by Ms. Fuller's counsel that further action would not be pursued. No one was in attendance on behalf of Ms. Fuller at the Board meeting.

Ms. Nichols moved to approve the Proposed Order and Findings of Fact of the Hearing Officer. Ms. Bell seconded that Motion and The Board unanimously approved the Motion.

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

- A. Internal Audit Report - ATRS Scanning Department for Period April 25, 2016 – June 24, 2016. Mitzi Ferguson presented the Committee with the Audit Report for the Scanning department.
- B. Internal Audit Report. Procurement for the Year Ended June 30, 2016. Shane Benbrook gave the year-end report.

- C. Internal Audit Follow-up Report: Call Center Presented February 1, 2016. Shane Benbrook and Mitzi Ferguson gave the follow up report to the Call Center Audit.
 - D. Internal Audit Follow-up Report: Teacher's Investment Management (TIM) System Presented October 5, 2015. Shane Benbrook gave the follow up report to the TIM system. He thanked the Investment Department for their hard work and cooperation on the TIM system.
- X. Investment Committee Report.** Ms. Robin Nichols, Chair, gave a report on the Investment Committee meeting.
- A. Investment Update.**
 - 1. List of Fund Closings
 - a. **Vista Foundation Fund III, L.P., a Private Equity Buyout Fund that Invests in Small to Middle Market Software Companies, the Board Authorized Commitment of up to \$30 Million Dollars on February 1, 2016. ATRS Obtained \$15 Million Dollars of the \$30 Million Dollar Recommended Allocation on May 19, 2016.** The final agreement for \$15 million dollars was negotiated, accepted, and closed on May 19, 2016.
 - b. **Nephila Capital Rubik Holdings, Ltd., an Opportunistic/Alternative Reinsurance Fund Specializing in Property Catastrophe Insurance Coverage, the Board Authorized Commitment of up to \$50 Million Dollars on April 4, 2016, was Accepted and Closed on June 1, 2016.** The ATRS full commitment of \$50 million dollars was negotiated, accepted, and closed on June 1, 2016.
 - c. **Harbert European Real Estate Fund IV, L.P., a Value Added Real Estate Fund Focused on Office, Industrial, Retail, and Residential Investments in Major European Markets, the Board Authorized Commitment of up to \$25 Million Dollars or Approximately €22 Million Euros on April 4, 2016, was Accepted and Closed on June 22, 2016.** The ATRS full commitment of \$25 million dollars or approximately €22 million euros was negotiated, accepted, and closed on June 22, 2016.

- d. **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 Authorized Commitment of up to \$35 Million Dollars on June 6, 2016, was Accepted and Closed on June 30, 2016.** The ATRS full commitment of \$35 million dollars was negotiated, accepted, and closed on June 30, 2016.
- e. **Altaris Constellation Partners, LP, a Private Equity Buyout Fund Specializing in Small to Middle Market Health Care Companies, the Board Authorized Commitment of up to \$20 Million Dollars on June 6, 2016, was Accepted and Closed on July 20, 2016.** The ATRS full commitment of \$20 million dollars was negotiated, accepted, and closed on July 20, 2016.
- f. **Arlington Capital Partners IV, L.P., a Private Equity Buyout Fund Specializing in Small to Lower Mid-Market Companies in the U.S. with Imminent Need, the Board Authorized commitment of up to \$30 Million Dollars on July 29, 2016. ATRS Obtained \$23 Million Dollars of the \$30 Million Dollar Recommended Allocation on July 29, 2016.** The final agreement for \$23 million dollars was negotiated, accepted, and closed on July 29, 2016.
- g. **Revenue Stream Generated by State of Arkansas Recycling Tax Credits Related to Big River Steel to be Paid by the State of Arkansas, the Board Authorized Commitment of up to \$162 Million Dollars (for \$300 Million Dollars in Recycling Tax Credits) on April 4, 2016 was Accepted and Closed on May 20, 2016. An amendment to the original agreement was negotiated and then executed on August 17, 2016 to obtain an early funding incentive rate for partial funding of the tax credit payment before the final payment date.** The ATRS full commitment of up to \$162 million dollars was negotiated, accepted, and closed on May 20, 2016. The exact amount of recycling tax credits to be issued by the state of Arkansas to Big River Steel is not yet finalized but has been determined to be an amount between between \$280 million dollars to \$330 million dollars (ATRS has capped the amount it will purchase at \$300 million dollars at a cost of \$162 million

dollars). The final purchase price of the revenue stream will be determined by the amount of recycling tax credits issued by the state of Arkansas with ATRS paying a maximum of \$162 million dollars (for \$300 million dollars of recycling tax credits). An amendment to the agreement was negotiated for a period of time after the initial close and executed on August 17, 2016. The amendment allows ATRS to obtain an early payment incentive rate for funding a portion of the purchase price before the funding date set in the original agreement that is well above the projected return in the fixed income portfolio at this time.

- h. Highland, LLC. A Wood Pellet Manufacturing Facility Located in the Pine Bluff Industrial Complex Adjacent to White Hall, Arkansas, with Imminent Need, the Board Authorized Commitment of up to \$25 Million Dollars on July 19, 2016, was Accepted and Closed on July 29, 2016.** The ATRS full commitment of \$25 million dollars was negotiated, accepted, and closed on July 29, 2016.
- i. LaSalle Asia Opportunity Fund V, L.P., an Opportunistic Real Estate Fund Focused on Both Debt and Equity Investments in Asia, the Board Authorized Commitment of up to \$30 Million Dollars on June 6, 2016, was Accepted and Closed on August 12, 2016.** The ATRS full commitment of \$30 million dollars was negotiated, accepted, and closed on August 12, 2016.
- j. CBRE Strategic Partners U.S. Value 8, LP, a Value Added Real Estate Fund Focused on Institutional Quality Multifamily, Office, and Retail Properties in the U.S. with Imminent Need, the Board Authorized Commitment of up to \$25 Million Dollars on July 19, 2016, was Accepted and Closed on August 19, 2016.** The ATRS full commitment of \$25 million dollars was negotiated, accepted, and closed on August 19, 2016.

2. Arkansas Related

- a. Recommendation to Modify Recallable Distributions for Funds Managed by Halderman Real Assets Management to Allow All Distributions Since Inception of the Account to be Recallable.** The Board

passed a motion at the December 7, 2015, meeting to allow Halderman Real Assets Management (HRAM) to recall distributions similar to other more direct investments by ATRS, such as the American Center, Almanac V, Almanac VI, Big River Steel, Blackstone, BlueOak, Carlyle VII, Franklin Park Venture Fund 2014, KPS III, Levine Leichtman, Atlas II, Lime Rock III, and Vista Foundation II. ATRS has the ability to reinvest in the projects through returning returned capital and distributions for reinvestment. The ability to accept distributions and later to redirect the distributions to the projects as needed versus having the currently unneeded capital held by outside management helps enhance ATRS returns by ATRS having the immediate use of the distributions for investments and cash flow.

The current Board motion states that only distributions made after the effective date of December 7, 2015, may be recalled. ATRS staff is requesting to make all distributions from HRAM since inception of the account in 2011 recallable by HRAM, with consent of ATRS staff and positive Board Chair notice. The ability to recall all distributions since inception of the program will allow proceeds from the sale of a farm and other distributions prior to December 7, 2015 to also be recallable and will add approximately \$8 million dollars from the farm sale and other distributions to remain deployable in the farmland program.

Ms. Nichols moved to approve to Modify Recallable Distributions for Funds Managed by Halderman Real Assets Management to Allow All Distributions Since Inception of the Account to be Recallable. The Board unanimously approved the motion.

B. General Investment Consultant Report.

- 1. Performance Report for the Quarter Ended June 30, 2016.**
P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting presented the portfolio update for the quarter ending June 30, 2016. The ATRS fund had a market value of approximately \$14.4 billion dollars. The total fund had a return of 8.2% since inception, underperforming its benchmark of 8.4%. Total equity had a market value of approximately \$8.1

billion dollars, underperforming its benchmark of -1.5%. This was primarily due to Pershing Square Holding returns being -5.8%, underperforming its benchmark of 13.6%.

2. **Preliminary Performance Report for the Month Ended August 31, 2016.** P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting presented the portfolio update for the month ending August 31, 2016. The ATRS fund had a market value of approximately \$14.8 billion dollars. The total fund had a return of 8.3% since inception, underperforming its benchmark of 8.5% for the month ending August 31, 2016.
3. **Total Equity Review: Recommendations and Rebalancing Update and Recap.** P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting (AHIC) will provide the Board with a review of the ATRS total equity portfolio and provide rebalancing updates and recommendations.

The annual review of the total equity portfolio by AHIC is designed to ensure the total equity portfolio is following the Board's objectives and long term goals. The results of this year's review provided opportunities to efficiently modify the current total equity allocations to continue the Board's objective of making the total equity portfolio more global and reducing the portfolio's current investments in small cap stocks.

- a. **Recommendation to Commit up to \$200 Million Dollars in AllianzGI Structured Alpha Global Equity 350 L.L.C., a Total Equity Fund that Uses Options Based on Global Markets Designed to Enhance the Returns of the Underlying Global Benchmark.** The Board approved changing the ATRS Statement of Investment Policy (SIP) to combine the previous domestic equity target allocation (20%) and the previous global equity target allocation (30%) into one global or total equity target allocation (50%) at the June 1, 2015, meeting. The update was recommended by AHIC and ATRS staff to help reduce the overlap in global and domestic equities since global equities can also contain domestic equities. The Board began the process at the June 2015 meeting by approving the conversion of the AllianzGI Structured Alpha U.S. Equity Fund 500 L.L.C. from a domestic based fund to a global based fund named the AllianzGI Structured Alpha Global Equity 500 Fund L.L.C. The Board continued the process at the October 5, 2015, meeting by approving the change of the

name and mandate of the domestic based Voya Absolute Alpha S&P 500 Trust Fund to the global based Voya Absolute Alpha MSCI AWCI Trust Fund.

As of July 31, 2016, ATRS has approximately \$700 million invested in two Allianz Structured Alpha funds. The AllianzGI Structured Alpha U.S. Equity 250 fund has approximately \$120 million dollars and the Allianz GI Structured Alpha Global Equity 500 fund has approximately \$580 million dollars. The 250 in the fund's name, AllianzGI Structured Alpha U.S. Equity 250, represents 250 basis points of tracking around the target index which, in this case, is the S&P 500 Index. The 500 in the global fund's name represents 500 basis points of tracking around the MSCI All Country World Index. If approved, the 350 fund would provide a nice compliment to the 500 fund by having a lower tracking error to the MSCI ACWI (350 basis points) than the 500 while still offering potential for added value. The strategy uses put and call options on a variety of indices to create “profit zones”. If the value of the index falls within those zones at expiration, the strategy profits from the structure of the options strategy. The manager adjusts these zones as market conditions change and limits the downside of the strategy by buying out of the money put options. The strategy is a net seller of options which creates premium income. This is similar to selling insurance – you pay a premium for the rights provided by the option or you collect premium to provide that right.

The investment in the 250 fund was initially made by ATRS in early 2008 as an options overlay separate account using the former Oppenheimer U.S. equity portfolio as its collateral source. The strategy migrated over time to its current form which is an LLC structure. The ATRS Board approved a domestic version of the 500 fund in October of 2013 and approved the change of the 500 fund's mandate from domestic to global on June 1, 2015, as part of the Board's objective to add more global opportunities to the investment portfolio. Performance of both strategies has been strong since inception and the volatility of the return has declined due in large part to enhancements made to the process. Given this, AHIC and ATRS staff recommend adding \$200 million dollars

to a similar strategy, the AllianzGI Structured Alpha Global Equity 350 L.L.C.

If approved, the recommendation for the 350 fund will be a separate and distinct fund so a new set of legal documents will need to be reviewed and executed by ATRS. The performance of each fund will be shown separately for comparative purposes. The strategy of the funds is the same with the exception of the tracking error risk level. Allianz has offered ATRS a lower fee structure for this account with a performance fee only structure of 25% of profits above the high water mark compared to the performance fee of 30% for the 250 and 500 accounts. The investment in the new fund will have a fresh high water mark which is beneficial given the current investments are well above the high water marks set for the 250 and 500 funds.

Ms. Nichols moved to adopt Resolution 2016-30, to Commit up to \$200 Million Dollars in AllianzGI Structured Alpha Global Equity 350 L.L.C., a Total Equity Fund that Uses Options Based on Global Markets Designed to Enhance the Returns of the Underlying Global Benchmark The Board unanimously adopted the Resolution.

- b. **Recommendation to Consolidate Assets Managed by Jacobs Levy Equity Management, Inc., by Closing the Jacobs Levy Core Equity Fund and Redeploying the Assets to the Existing Jacobs Levy 130/30 Core 3 Fund, LLC, the Existing BlackRock MSCI ACWI IMI Index Fund A, and Fund the Proposed New Allocation to the AllianzGI Structured Alpha Global Equity 350 L.L.C.** ATRS has a long relationship with this firm. ATRS began investing with Jacobs Levy Equity Management in 2006 using the firm's Core Equity Fund and expanded the firm's mandate by approving the 130/30 fund in 2008. The Core Equity Fund is benchmarked to the Russell 3000. Of the 3000 stocks in this index, 1000 are considered to be large cap stocks with the other 2000 considered to be small cap stocks. The Jacobs Levy Core Equity Fund invests in this universe of 3000 stocks including the 2000 small cap stocks in this index and has performed well. Given the

small cap nature of the assets managed by Jacobs Levy, both AHIC and ATRS staff recommend consolidating the assets managed by Jacobs Levy to help reduce the current small cap bias of the ATRS total equity portfolio.

The Jacobs Levy 130/30 strategy is also benchmarked to the Russell 3000 and seeks to hold long positions of 130% of the portfolio and 30% short positions of the portfolio. Long positions means the investment manager buys a stock expecting it to rise in value. Short positions means the investment manager borrows a stock rather than buying it and sells the borrowed stock expecting the price of the stock to decline so the manager can buy the stock at a lower price than when it was borrowed and repay the higher priced borrowed stock with the stock the manager bought at a lower price producing a profit. The 130/30 strategy seeks to use the profit made from the short sell of stocks to reinvest in the long positions of the portfolio in order to enhance the value of the portfolio.

This strategy has also performed well and based upon the success of the strategy, AHIC and ATRS staff recommend closing the Core Equity Fund and consolidating those assets into the existing 130/30 fund, the existing BlackRock MSCI ACWI IMI Index Fund A, and funding the new allocation to the AllianzGI Structured Alpha Global Equity 350, if approved. The consolidation of the accounts managed by Jacobs Levy should increase the value of the 130/30 fund by \$200 million dollars from approximately \$230 million dollars to approximately \$430 million dollars with the remaining \$225 million dollars being used to fund the proposed Allianz 350 allocation and replenish the BlackRock ACWI index.

Ms. Nichols *moved to adopt* Resolution 2016-31, to Consolidate Assets Managed by Jacobs Levy Equity Management, Inc., by Closing the Jacobs Levy Core Equity Fund and Redeploying the Assets to the Existing Jacobs Levy 130/30 Core 3 Fund, LLC, the Existing BlackRock MSCI ACWI IMI Index Fund A, and Fund the Proposed New Allocation to the AllianzGI Structured Alpha Global Equity 350

L.L.C. The Board *unanimously adopted the Resolution.*

- c. Recommendation to Consolidate Assets Managed by Voya Investment Management Company, LLC, by Closing the Voya Small Cap Growth Fund and Redeploying the Assets to the Existing Voya Absolute Alpha MSCI ACWI Trust Fund, the Existing BlackRock MSCI ACWI IMI Index Fund A, and Fund the Proposed New Allocation to the AllianzGI Structured Alpha Global Equity 350 L.L.C.** P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting.

ATRS also has a long relationship and great relationship with Voya. The Board hired Voya (known as Aeltus at the time, then later as ING, now known as Voya) in 1999 to manage a small cap growth strategy. In 2008 the Board expanded Voya's role to also manage a portable or absolute alpha strategy for ATRS. The absolute alpha strategy seeks to generate alpha or excess return over a benchmark. The fund employs a fund-of-funds approach under which the manager invests primarily in other collective trust funds, pooled vehicles, and various forms of derivatives. Derivatives are used to manage the fund's market exposure, or beta, to closely approximate that of the fund's benchmark. As part of the Board's objective to add more global investments, the Board approved changing the benchmark of this fund from domestic to global at the October 5, 2015, meeting.

This strategy has also performed well but similar to the Jacobs Levy Core Equity Fund, this fund is focused on small cap stocks and as such AHIC and ATRS staff recommend closing the small cap growth fund and consolidating those assets into the existing absolute alpha fund, the existing BlackRock MSCI ACWI IMI Index Fund A, and funding the new allocation to the AllianzGI Structured Alpha Global Equity 350, if approved. The consolidation of the accounts managed by Voya should increase the value of the absolute alpha fund by \$200 million dollars from approximately \$210 million dollars to approximately \$410 million dollars with the remaining \$75 million dollars being used to help fund the proposed

Allianz 350 allocation and replenish the BlackRock ACWI index. The recommendation is based on the results of the annual total equity review and should help increase ATRS's global investment opportunities while at the same time reducing the small cap bias in the portfolio.

Ms. Nichols *moved to adopt Resolution 2016-32, to Consolidate Assets Managed by Voya Investment Management Company, LLC, by Closing the Voya Small Cap Growth Fund and Redeploying the Assets to the Existing Voya Absolute Alpha MSCI ACWI Trust Fund, the Existing BlackRock MSCI ACWI IMI Index Fund A, and Fund the Proposed New Allocation to the AllianzGI Structured Alpha Global Equity 350 L.L.C. The Board *unanimously adopted the Resolution.**

- d. **Rebalancing Update and Recap.** Mr. Hopkins reported that at the April 21, 2016, meeting the Board updated the Statement of Investment Policy to clarify the language and duties associated with rebalancing the ATRS portfolio. The Board approved language allows the executive director, after consultant recommendation and positive notice to the Board Chair, to rebalance funds across the various equity and fixed income managers and holdings. In addition to identifying opportunities and recommendations to continue to make the total equity portfolio more global, the annual review has also identified some rebalancing opportunities that should also help reduce the portfolio's investments in small cap stocks. While no Board action is required for the rebalancing, given the timing of the Board meeting, ATRS staff is providing the Board with an update and recap of the rebalancing plan based on the findings and recommendations of the AHIC total equity review.

The rebalancing to better align the ATRS equity portfolio with long term opportunity views includes redeploying \$50 million dollars from Kennedy Capital Management, \$50 million dollars from Wellington Management Company, and \$50 million dollars from the Allianz Global Investors convertible bonds portfolio (formerly known as

Nicholas Applegate). The redeployment has nothing to do with the quality of these fine managers but everything to do with rebalancing to catch the favorable winds in the market. The funds from these managers will be used to help fund the proposed Allianz 350 product and help replenish the BlackRock MSCI ACWI IMI Index Fund A. The BlackRock MSCI ACWI fund is a passive global index that serves as ATRS's primary source of monthly liquidity needs and requires additional funding from time to time. Since the Kennedy and Wellington accounts have a focus upon small cap stock investments, the redeployment of the withdrawn funds will help reduce the equity portfolio's small cap bias, add to the system's global investments, and help replenish ATRS's primary source of liquidity. The overall rebalancing plan will redeploy approximately \$450 million dollars from existing programs with \$200 million dollars being used to fund the proposed new Allianz 350 fund and approximately \$250 million dollars being used to replenish the BlackRock MSCI ACWI Index.

C. Private Equity

1. **Preliminary Private Equity Portfolio Review for the Quarter Ended June 30, 2016.** Michael Bacine of Franklin Park presented the private equity report for the quarter ended June 30, 2016. ATRS Legacy Portfolio is in liquidating stage and has a remaining value of 2.1% with a total IRR of 9.2%. CSFB Portfolio is also liquidating and will continue to see distributions. CSFB has a remaining value of 19.9% with a net IRR of 8.5%. The Post 2006 Portfolio represents 2/3 of ATRS portfolio and will continue to grow as more commitment to capital. The Post 2006 Portfolio has a net IRR of 14.6%. The total fund had a net IRR of 9.9% for the quarter ended June 30, 2016.

XI. Operations Committee Report.

- A. **Open Forum for Potential Rule or Law Changes by Committee Members and Board Members in Attendance.**
 1. **Open Forum.** Mr. Hopkins reported on his recent visit with the actuaries. Discussions were on ATRS benefit structures and other related items. ATRS continues to tighten our benefits to stay strong

and stable. Items in the future will be brought before the committee and board regarding this matter.

B. Potential 2017 Legislation.

1. Alternative Method to Assist Employers and Members in Dispute Settlements by Shifting to Actuarial Cost Methods.

Draft legislation has been approved to calculate the value of a future benefit in settlement agreements to address previous salary underpayments in settlement claims. Additionally, the current law allows for the purchase of service credit at actuarial cost under a settlement agreement or court order to resolve a claim of wrongful termination. That type of purchase is known as "air time" service. Both of these methods allow ATRS to recover the actuarial value of benefits to be paid to the member.

The current collection of employer contributions on a settlement payout most often provides no benefit enhancement to members. The current process often leads to the angst of both members and employers. ATRS employers often do not expect to pay employer contributions on a settlement agreement or court order, and the member usually receives no value in under this arrangement.

The Committee requested draft legislation to be presented at the next Board meeting.

- 2. Outsourcing Update.** Clint Rhoden, Dir. of Operations, gave a brief update on the outsourcing salary study done in house to address actuarial concerns of decreases in the number of employees covered under the system. The number of covered employees continues to decline and the 3.25% projection of annual growth in employee payroll that the actuaries project are not being met. One of the reasons given was the drop in the number of covered employees. The in-house study involved taking the total decline in member numbers and salary over the past six (6) years and drilling down to find the suspected impact of outsourcing. The group of members with the biggest drop in numbers was the group that consisted of noncontributory classified staff that had an annual salary of \$10,000 or less. However, some outsourcing personnel are making over \$10,000, and the number continues to grow.

The Committee had extensive discussion on this matter. The Committee's number one priority is to keep this system sound and solvent. Mr. Hopkins will be attending all the Co-Op meetings and will be addressing outsourcing. The Committee asked staff to draft legislation that would include a potential surcharge or a blended model, and a delay or phase in period, to be presented at the next Board meeting.

3. **Potential Rule Modification to Buyout Plan for Inactive Vested Members.** In the 2013 legislative session, a buyout plan was authorized by the General Assembly to allow the ATRS Board to establish a buyout plan by rule to make a one-time lump-sum payment in exchange for the exchange for the accrued benefits in ATRS of the buyout participant. This plan is referred to as the Cash and Savings Help Program for Members (CASH). To date, ATRS has offered this one-time lump-sum payment to inactive vested members who have **only** noncontributory service credit. The system has paid this benefit to 1,956 members.

The Board can adopt an addition buyout program by rule for a group of inactive vested members who have all contributory service credit, or mixed contributory and noncontributory service credit by a **rule making** process. The ATRS executive staff is developing formulas to propose to the Operations Committee to expand the CASH program to all inactive vested members and not just to totally noncontributory members. ATRS will work closely with our actuaries to arrive at a formula that gives the group of members with all contributory or mixed service credit an opportunity to obtain a lump-sum payment to cancel service credit.

In addition, ATRS executive staff is working to develop legislation to move long term inactive members who are over 65 years old automatically into a cash program benefit platform to better align the impact of unfunded liabilities of ATRS with inactive vested members that are no longer interacting with ATRS. This change would take several million dollars per year of liability off the books of ATRS. ATRS staff recommends this change in order to remove old liability off the books that is often carried until well after the inactive vested members are deceased.

The Committee asked staff to draft legislation and present at the next Board meeting.

4. **A Proposed Change to the 2013 Permissive Legislation that allows the ATRS Board to address funding status By Allowing Certain Changes to be Implemented Sooner than Currently Allowed in Order to Give the ATRS Board the Ability to have Faster Reaction and more immediate Implementation if needed for Continued Actuarial Soundness.** In 2013, the General Assembly passed permissive legislation to allow the ATRS Board to make benefit changes to address financial issues like those caused by the 2008 and 2009 financial crisis throughout the world. The ATRS Board may make adjustments to the items by resolution at any Board meeting, so long as the system's actuary has certified to the Board that the amortization period exceeds thirty (30) years. The ATRS Board does not adopt the actuarial reports until the first regular meeting of the calendar year, for the preceding June 30 fiscal year. That means by the time the Board adopts the report, over six (6) months have passed in the fiscal year without any opportunity for the ATRS Board to take action. In retrospect, ATRS staff thinks the Board should be able to react sooner rather than later if there are expected market downturns or other changes that would affect the actuarial status of the system.

The Operations Committee asked staff to draft legislation and bring to the next Board meeting.

C. Pending Committee Approval.

1. **Spousal Benefit Rights Waived for Survivor Benefits.** If active or T-DROP members are married for two (2) years preceding the member's death, the surviving spouse is **automatically** entitled to a lifetime benefit, even if the member has chosen and would continue to choose 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 regardless of the member's desire. The discussion at the last Operations Committee meeting indicated support for 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 was married to the member for two (2) or more years, the right of the surviving spouse supersedes the

beneficiary designation that may have been to the deceased member's children from a prior marriage, and would provide the surviving spouse with a lifetime Option A benefit and the T-DROP balance.

One potential change would be to allow the member to override the law on spousal priority by having the residue beneficiary form allow the override to the beneficiaries if chosen very specifically by the member to do so. Draft legislation was provided for Committee review.

Mr. Lester *moved to approve draft legislation for Spousal Benefit Rights Waived for Survivor Benefits. The Board *unanimously approved the motion.**

2. **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 recognized that a problem existed with the promotion decision due to litigation. ATRS law does not currently clearly 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 method of calculation would address underpayments of salary awarded in a settlement agreement. Draft legislation was provided for Committee review.

Mr. Lester *moved to approve draft legislation for Settlement Agreements Designed to Address Previous Benefit Underpayments in Claims of Wrongful Termination. The Board *unanimously approved the motion.**

3. **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.** Currently, an ATRS member can participate in T-DROP a full ten (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. By this proposed change, the member could continue to work and not retire, even after 10 years by participating in the Post 10 Year T-DROP plan. Draft legislation was provided for Committee review.

Mr. Lester *moved to approve* draft legislation for 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. The Board *unanimously approved the motion.*

4. **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.

In the June 6, 2016, Operations Committee/Board of Trustees meeting, ATRS made a recommendation to clarify this section of the law to include a direct purchase of an investment, or a loan such as the recent Arkansas Development Finance Authority loans and the Operations Committee and Board concurred. Since this was not a material change to this section of the law, and since there will not likely be another loan type

that would fall under this section, ATRS staff recommends this potential change be placed on hold.

The Committee took no action on this matter at this time.

- D. Reduction in Paper Checks produced by State Auditor's Office.** In the February 1, 2016, Board meeting, Auditor Lea asked ATRS to evaluate the possibility of reducing the number of paper checks printed for the System by the Auditor's Office. ATRS had just over 16,000 paper checks printed by the Auditor's Office during calendar year 2015. The majority of the paper checks were issued to retirees who have not signed up with ATRS to have direct deposit using electronic fund transfer (EFT). Of the 16,000 checks issued, 11,700 paper checks issued for retirees during 2015, or approximately 975 per month. The average number of paper checks issued to retirees so far in 2016 is 939.

Auditor Lea suggested that ATRS contact our retirees to request that they use EFT, listing the benefits of EFT such as no lost checks, reliable deposit dates, and convenience. ATRS would include the forms and instructions for signing up for EFT in the mailing, as well as instructions for signing up for direct access to their personal retirement account information through the ATRS website member portal. ATRS currently has retiree pay information on its member portal, as well as the retiree benefit payroll schedule of direct deposit dates. This is a very effective first step to the process.

Because there is currently no law or rule that requires retirees to use EFT, ATRS strongly recommends that retirees use EFT, but does not enforce it as a requirement. At the time of retirement, ATRS provides the EFT form when retirees are enrolled.

Auditor Lea suggested that staff use DFA state guidelines regarding paper checks. The Committee recommended that the staff work with Auditor Lea to implement a solution to be presented to the Board. Staff will review the State's procedures and report back to the Committee at the December meeting.

XII. Staff Reports.

- A. Medical Committee Reports.** Michael Ray presented the Medical Committee reports. A total of fifty-six (56) disability applications were

received, fifty-two (52) were approved for disability benefits, two (2) were denied benefits, and two (2) needed more information.

Ms. Nichols *moved to approve* the Medical Committee Reports. Mr. Knight *seconded the motion*, and the Board *unanimously approved the motion*.

XIII. Other Business: None

XIV. Adjourn.

Mr. Lester *moved to adjourn* the Board Meeting. Ms. Bell *seconded the motion*, and the board *unanimously approved the motion*.

Meeting adjourned at 11:59 a.m.

George Hopkins,
Executive Director

Mr. Jeff Stubblefield, Chair
Board of Trustees

Tammy Porter,
Recorder

Date Approved