

MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING

Dr. Richard Abernathy, Chair

Monday, April 2, 2012

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
Dr. Tom Kimbrell
Danny Knight
Bobby Lester
Susannah Marshall, designee for Candace
Franks
Donna Morey
Robin Nichols
Janelle Riddle
Jeff Stubblefield

Consultants Present

Michael Bacine, Franklin Park
Chae Hong, Hewitt EnnisKnupp
P. J. Kelly, Hewitt EnnisKnupp

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

Staff Present

George Hopkins, Director
Gail Bolden, Deputy Director
Kay Daniel, Director's Assistant
Dena Dixson, Internal Audit/Risk Mgmt
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Tammy Porter, Paralegal
Michael Ray, Dir. Member Service
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Internal Audit/Risk Mgmt

Guests Present

Alex Blankenship, Div. Legislative Audit
Bill Brazil, Annette Hodges' Attorney
Chris Caldwell, Div. Legislative Audit
Sarah Ganahl, Bureau of Leg. Research
Sharon Hill, Court Reporter
Annette Hodges, ATRS Member
Nick Kasikis, State Street
Charles Tadlock, ARTA
Lisa Tyrrell, State Street
Steve Singleton, ARTA

- I. **Call to Order/Roll Call.** Chair, Dr. Richard Abernathy, called the Board of Trustees meeting to order at 1:00 p.m. Roll call was taken. All members were present.
- II. **Motion to Excuse Absences.** There were no absences to excuse.

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III. **Adoption of Agenda.**

Mr. Lester moved for adoption of the Agenda. Ms. Nichols 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. **Minutes of February 6, 2012.**

Ms. Leming moved for approval of the Minutes of the Board of Trustees meeting of February 6, 2012. Ms. Coleman seconded the motion, and the Board unanimously approved the motion.

B. **Minutes of March 12, 2012.**

Ms. Riddle moved for approval of the Minutes of the Board of Trustees meeting of March 12, 2012. Ms. Morey seconded the motion, and the Board unanimously approved the motion.

VI. **A [REDACTED] H [REDACTED] Appeal.** Ms. H [REDACTED] and Mr. William C. Brazil, Ms. H [REDACTED] attorney, came before the Board due to a Remand to the Board by the Faulkner County Circuit Judge to consider an additional document as evidence to Ms. H [REDACTED] appeal. The Board was asked to consider additional documentation and records associated with the document. The Board may affirm the decision of the Hearing Officer, reject the decision of the Hearing Officer and impose its own decision, modify the order, make its own findings, or remand the matter back to the Hearing Officer for additional consideration of matters the Board deems appropriate.

Mr. Knight moved to affirm the Hearing Officer's decision in the matter of A [REDACTED] H [REDACTED] appeal. Mr. Stubblefield seconded the motion. The motion carried. Nae vote was recorded for Ms. Riddle.

VII. **S [REDACTED] W [REDACTED] Appeal.** Ms. Gilson presented the appeal for S [REDACTED] W [REDACTED] regarding his eligibility for disability benefits. The Hearing Officer provided a proposed decision for the Board. The Board may affirm the decision of the Hearing Officer, reject the decision of the Hearing Officer and impose its own decision, modify the order, make its own findings, or remand the matter back to the Hearing Officer for additional consideration of matters the Board deems appropriate.

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Mr. Lester moved to affirm the Hearing Officer's decision in the matter of S██████ W██████ appeal. Ms. Nichols seconded the motion, and the Board unanimously approved the motion.

VIII. **Report of Member Interest Amount Waived Under A.C.A. Sec. 24-7-205.** Mr. Hopkins reported member interest waived since December 2011. There was one waiver for a total of \$92.46.

IX. **Report of Employer Interest and Penalties Waived Under A.C.A. Sec. 24-7-411.** Mr. Hopkins reported employer interest and penalties waived since December 2011. ATRS recently converted from a paper reporting system to an electronic file reporting system. Just after this conversion, several employers had to adjust to a new system and ATRS waived ALL penalties as ATRS employers became adjusted to the new process. ATRS has waived a total of \$2,556.56 since December 2011.

X. **Legislative Audit Report, June 30, 2011 – No Findings.** Mr. Hopkins presented the Legislative Audit Report of June 30, 2011. There were no findings. The law requires that each public board review its Legislative Audit report in a public meeting. The law requires that the public board review any findings, and then file the report.

Dr. Kimbrell moved to approve the Legislative Audit Report of June 30, 2011 as presented. Ms. Riddle seconded the motion, and the Board unanimously approved the motion

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

A. Potential Rule Changes – Operations Committee Discussion Item.

1. **Policy 1-18 Audit Committee Charter.** In Policy 1-18, the Audit Committee charter, it was ATRS' staff's recommendation to remove certain mentions of the Executive Director and replace them with Internal Auditor. Ms. West wanted this item brought to the Audit Committee's attention.

B. Internal Audit Report – Benefit Calculations and Disbursements. No recommendations or action necessary.

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

A. Renewal of Consulting Contracts.

1. **Hewitt EnnisKnupp Investment Consultant.** HEK has asked that the contract amount be increased to reflect the additional duties the firm has taken on in the form of hedge fund and farmland management. The proposed increase is \$55,000, or 5%, of their current fee.

Ms. Leming moved to approve the changes to the Hewitt EnnisKnupp investment consultant contract. Ms. Nichols seconded the motion, and the Board unanimously approved the motion.

2. **Franklin Park Private Equity Consultant.** The Board previously approved a contract increase of \$250,000 due to the additional duties the firm has taken on in the form of co-investments. There were no further material changes, and no Board action was needed

B. Arkansas Real Estate Update.

1. **Victory Building.** The Victory Building continues to maintain quality cash flow and maintains high occupancy. An occupant did leave the building, but the space was immediately filled.
2. **Arkansas Farmland.** The farmland manager is in the process of adding additional acreage to the Indiana property from the same family that sold the initial acreage to ATRS. ATRS continues to seek high quality farmland in Arkansas and in other locations.
3. **Woodland Heights.** Woodland Heights has seen an increase in occupancy. The current occupied rate is 72% and the occupied and preleased rate is 73%. It appears that RPM has engaged quality staff and a good approach to marketing. It also appears that RPM is on schedule to meet the occupancy levels that were provided to this Committee and the Board in the February Board meetings.
4. **Insurance Department.** The construction on the building at 1500 West 3rd Street continues to go well. This will be the location for the Criminal Investigation Division of the Arkansas Insurance Department. ATRS staff is pleased that a building which had been unoccupied for a long period of time now should have a quality and stable tenant to provide quality cash flow and return.

C. General Investment Consultant Update – Hewitt EnnisKnupp.

1. **Preliminary Portfolio Performance Update for the Month Ended February 29, 2012.** The total fund met the benchmark of 2.8% for the month ended February, 29, 2012. U.S. equity performed below the

benchmark of 4.2% at 3.5% for the month ended February 29, 2012, but is outperforming the benchmark of 9.5% at 10.5% for year to date. Global equity was at 5.6%, outperforming the benchmark of 5.0% for the month ended February 29, 2012. Fixed income was at 0.9%, outperforming the benchmark of 0.2%. The alternatives portfolio met the benchmark of 0.7% for the month ended February 29, 2012.

2. **Asset Liability Study.** As of June 30, 2011, the plan is 77% funded on market value basis and 72% funded on actuarial value basis. From the last actuarial valuation, the total employer contribution rate is 14.00% of payroll. The ratio of the unfunded liability (\$3.626 billion dollars based on market value of assets) to the scheduled payroll (\$2.728 billion dollars) is 133%. Despite favorable asset performance for the fiscal year ending 2011, the plan's deficit increased as the unrecognized losses from previous years are gradually reflected. The employer contributions exceeded the value of new benefit accruals by about \$233 million dollars, which represents an amortization payment for the plan's deficit and interest payment for underfunding.

Currently, the unfunded liability is about \$4.375 billion dollars and annual normal cost is about \$198 million dollars. Given the fixed level of the contribution rate, the funded status is expected to decline over the next 15 years from 72% to around 60%. It is reasonable to keep the current allocation to growth assets.

D. Real Estate Consultant Update – Hewitt EnnisKnupp.

1. **Verbal Preliminary Portfolio Performance Update for the Quarter Ended December 31, 2011.** Approximately 80% of the real estate managers had reported fourth quarter results at the time of the Board meetings. Net IRR had a 2.6% return for the quarter, underperforming the benchmark of 2.96% in the fourth quarter of 2011.
2. **Recommendation of up to \$30 Million to Rockwood Capital Real Estate Partners Fund IX, L.P.** Rockwood Fund IX is a closed end Value Added fund focused on building a portfolio of U.S. real estate with a combination of strong in-place income and the potential for income growth through real estate related value creation activities. The Fund will primarily make equity investments but does have the ability to make some structured investments in the debt portion section of the capital stack. The Fund will focus on building a portfolio of real estate investments that has both strong in-place cash flow and the potential for near-term income growth through value creation activities such as leasing, re-leasing, repositioning, redeveloping, and changing use. Fund IX may also engage in ground-up development, generally where

income is expected to be put in place within 36 to 48 months of acquisition. The major merits for this recommendation are a well-conceived and measured investment approach, a strong alignment of interests, a solid track record, and the stability of a senior team.

The Investment Committee recommended a commitment of up to \$30 million dollars.

a. **Resolution 2012-12.**

Ms. Leming moved to adopt Resolution 2012-12, approving a commitment of up to \$30 million dollars to Rockwood Capital Real Estate Partners Fund IX, L.P. Mr. Cauldwell seconded the motion, and the Board unanimously adopted the resolution.

E. Private Equity Investment Consultant Update – Franklin Park.

1. **Recommendation of up to \$35 Million to Riverside Fund V. L.P.** Riverside Fund V will primarily pursue acquisitions of small, profitable healthcare and technology companies in the United States. The General Partner will focus on family- and management-owned companies with enterprise values between \$25 million and \$150 million. Post investment, Riverside seeks to increase value of portfolio companies through growth initiatives and operational improvements. The General Partner targets an attractive market segment, has a highly experienced and complementary team, and the track record is tenured and attractive.

The Investment Committee recommended a commitment of up to \$35 million dollars.

a. **Resolution 2012-13.**

Ms. Leming moved to adopt Resolution 2012-13, approving a commitment of up to \$35 million dollars to Riverside Fund V, L.P. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

2. **Recommendation of up to \$35 Million to Court Square Capital Partners III, L.P.** Court Square is being formed to primarily make leveraged acquisitions of mature, upper middle market companies in the U.S. The General Partner will target companies with enterprise values of \$150 million to \$1.0 billion. The General Partner will primarily seek companies in the following sectors: business services, general

industrial, healthcare and telecom & technology. The General Partner team is highly experienced and cohesive, and has an attractive track record.

The Investment Committee recommended a commitment of up to \$35 million dollars.

a. **Resolution 2012-14.**

Ms. Leming moved to adopt Resolution 2012-14, approving a commitment of up to \$35 million dollars to Court Square Capital Partners III, L.P. Ms. Marshall seconded the motion, and the Board unanimously adopted the resolution.

3. **Recommendation of up to \$35 Million to TPG Credit Strategies Fund II, L.P.** TPG Credit Strategies Fund II, L.P. is being formed to pursue an opportunistic distressed investment strategy, with a primary focus of acquiring assets such as non-performing loan portfolios, aviation assets, corporate debt and other distressed assets. The General Partner will primarily seek opportunities in the U.S. and Europe. Post-acquisition, the General Partner will actively manage the assets through loan recoveries, liquidations and restructuring. The Fund's strategy should generate attractive risk adjusted returns and the General Partner's core strategy targets attractive segments of the distressed market. The team is highly experienced and well-positioned in the distressed asset market and has an attractive aggregate track record.

The Investment Committee recommended a commitment of up to \$35 million dollars.

a. **Resolution 2012-15.**

Ms. Leming moved to adopt Resolution 2012-15, approving a commitment of up to \$35 million dollars to TPG Credit Strategies Fund II, L.P. Mr. Stubblefield seconded the motion, and the Board unanimously adopted the resolution.

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

- A. **Actuarial Study of Increasing Penalty for Early Retirement.** In the February 6, 2012, Board meeting, ATRS staff proposed increased penalties for early retirement as a cost savings measure. The Committee and Board requested an actuarial study for further information. The

actuaries sent a report stating that savings would be minimal, 0.02% of payroll over a 30 year amortization period. The Committee decided to not pursue this item as the savings would not be worth the cost and effort of implementation.

B. Recommendation for Amended Rules and Regulations Subject to Administrative Procedures Act. These rules have either already been approved by the Board or require implementation due to changes in the law.

1. **Policy 1-18 Audit Committee Charter.** The current wording of Policy 1-18 provides that the Committee Chair or Executive Director may call the meetings and set the agendas for the Audit Committee. As internal audit processes have developed at ATRS, it has been determined that it is best for the Internal Auditor and the Audit Committee Chair to work together to establish agendas and activities of this independent committee's processes. ATRS executive staff recommends removing references to the Executive Director as making decisions and replacing those references with the ATRS Internal Auditor for these functions. In addition, the ATRS internal auditor has reworked the rules for the Audit Committee to more clearly state the process and function of the ATRS Audit Committee. This rule change was reviewed and approved by the Board in its February 6, 2012, meeting.

2. **Policy 6-1 Membership Definitions and Rules.** The current rule denies any new employees of certain specialized employers from establishing membership with ATRS unless the new member had prior service in ATRS with another employer. The law has changed since 2006 when this policy was created. The proposed rule allows new employees of these employers to become ATRS members if ATRS staff determines that the employer is an eligible employer. This rule change was reviewed and approved by the Board in its February 6, 2012, meeting.

3. **Resolution 2012-16.**

Mr. Lester moved to adopt Resolution 2012-16, approving the amended rules and regulations subject to the Administrative Procedures Act. Ms. Nichols seconded the motion, and the Board unanimously adopted the resolution.

C. Recommendation for Amended Rules and Regulations Not Subject to Administrative Procedures Act. The rule becomes effective immediately upon adoption by the ATRS Board of Trustees.

1. **Policy 3-9 Operations.** This policy requires an audit by an external auditor to be performed at least every five years. The policy was implemented before ATRS had an Internal Auditor position. With the oversight of both the Division of Legislative Audit and the ATRS Internal Audit section, the Board should consider removing this requirement since it is duplicative and an unnecessary expense unless there are compelling reasons why the work of Legislative Audit and the Internal Auditor should be reviewed due to some event or occurrence. If justification occurs, then the audit could be implemented by the Board by regular vote to authorize such an audit. This proposed rule was reviewed and approved at the February 6, 2012, Board meeting.

- a. **Resolution 2012-17.**

Mr. Lester moved to adopt Resolution 2012-17, approving Policy 3-9 (Operations) as amended. Ms. Coleman seconded the motion, and the Board unanimously adopted the resolution.

D. Adoption of Rules Under Emergency Rules Making Status.

1. **Policy 7-2 Proof of Service Credit.** This rule is needed to maintain proper service credit for special function employees like bus drivers and lunchroom workers. The proposed rule is intended to maintain service crediting as it has always been done by bookkeepers. This rule change is being proposed in order to prevent unintended consequences from the ATRS Membership Department having educational seminars to better educate employers on the requirements for ATRS recordkeeping, including requirements for a day of service. In order to prevent confusion and to ensure that members continue getting a day of service for a typical day of work, ATRS staff has drafted a new rule that recognizes the days of service credit on employee contracts and specifies that, if a non-contracted individual is performing a typical day of service for the position the member occupies, then even if the member works less than four hours in a day, the member earns a day of service credit. Earning a day of service credit is even more important since ATRS has moved to 160 days to obtain a year of service credit.
2. **Policy 8-2 Refund of Contributions.** This proposed rule affects the refund of member contributions. The proposal lowers the rate of interest paid on member accounts to 1%, effective July 1, 2012. Currently, the interest rate on member accounts is 2%. ATRS has reviewed bank certificate of deposit (CD) rates throughout Arkansas and finds that most CD rates are less than 1%. A typical member who

stays in ATRS and retires never encounters the issue of this interest rate. The only time a member will encounter this interest rate will be when a member terminates service and obtains a refund, an active member dies and has no eligible beneficiaries for the monthly benefit, or a retiree dies before their drawn benefits are equal to all contributions plus interest.

Until approximately two years ago, this rate was 6% and often encouraged relatives of members to leave account balances at ATRS to obtain 6% interest rather than claiming the residual balances of deceased members. In the 2011 Session, ATRS eliminated paying future interest on residual balances of deceased members past the first July 1 after death to address that very issue. In this instance, ATRS staff feels that a 1% interest rate reflects the market rate or better that most individuals could get on these balances if these balances had been moved to a different financial account.

This rule also eliminates the need to prove a hardship to begin getting a refund. ATRS has been reticent in paying member refunds to protect the member and prevent multiple purchase accounts. A refund paid in two installments required two purchase accounts. In the past, before actuarial cost for service purchases, ATRS required a member to prove a hardship in order to get a refund in two payments rather than wait for six months until all accounting on the member's account was final.

The proposed rule allows members to take refunds in two installments with the first installment consisting of all service credit that has been reported, audited, and closed on the ATRS books by the ATRS Accounting/Reporting Department. This will allow the member to usually receive a large portion of the amount of money the member would otherwise be entitled to receive. Now that ATRS uses actuarial purchase of service, it is no longer an issue of to set up more than one purchase account. In addition, ATRS had set up a process by which members who face critical needs can get two payments in any event. When all the member's contributions are final and closed on the ATRS books, the member will receive a second check paying the balance. It is important to remember that ATRS policy says that once any part of a refund is paid, all service credit in the account is cancelled, therefore, there is no advantage to a member taking two payments of a refund, since the first refund voids all service credit.

- 3. Policy 10-3 Teacher Deferred Retirement Option Plan (T-DROP).** This proposed rule has a provision that will allow members exiting T-DROP to place all or part of their T-DROP proceeds into a cash

balance account (CBA) at ATRS. The proposal is for ATRS to provide staggered interest rates of between 2% and 4% based upon how long the member leaves money in the cash balance account at ATRS. It is designed to encourage long term money to be held at ATRS by the member.

Members would not be allowed roll money into the ATRS cash balance account as it would violate IRS requirements of a defined benefit plan. A member may take cash distributions up to four times per year and also may roll money out to another administrator at those times. Staff also placed an emergency override proposal to allow a member to have an additional withdrawal in a quarter based upon a manifest need such as a death or urgent financial problem.

If the Operations Committee and Board approves this policy, the earliest time that rule would be effective through regular rule making would be either in late May 2012, or early June 2012. Such a late effective date would cause problems for both members needing certainty and staff providing counseling and preparing effective forms. To avoid these problems, this rule is proposed as an emergency rule to be effective immediately.

4. Resolution 2012-18.

Mr. Lester *moved to adopt* Resolution 2012-18, adopting by consent agenda Policy 7-2 (Proof of Service Credit), Policy 8-2 (Refund of Contributions), and Policy 10-3 (Teacher Deferred Retirement Option Plan T-DROP) under emergency rule making status. Ms. Nichols *seconded the motion*, and the Board *unanimously adopted the resolution*.

XIV. Staff Reports.

A. Medical Committee Reports. Mr. Ray presented the Medical Committee reports for February 2012 and March 2012. In February 2012, there were 25 applicants and all were approved. In March 2012, there were 27 applicants, 24 were approved and three were denied.

Ms. Nichols *moved to approve* the February 2012 and March 2012 Medical Committee reports. Mr. Knight *seconded the motion*, and the Board *unanimously approved the motion*.

XV. Other Business.

XVI. Adjourn.

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

Meeting adjourned at 2:01 p.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Amy Glavin,
Recorder

Date Approved