MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
MAY 19, 2010

The regular quarterly meeting of the Board of Trustees of the Arkansas Public Employees Retirement System was held on Wednesday, May 19, 2010 at 9:00 a.m., in the Conference Room, 124 West Capitol, Little Rock, Arkansas. Mr. Artee Williams presided.

QUORUM PRESENT:
Mr. Williams recognized the presence of a quorum.

BOARD MEMBERS PRESENT:
Mr. Artee Williams (State Employee Member), *Chair*, Director, Dept. of Workforce Services
Mr. Maurice Henry (School Employee Member), *Vice-Chair*, Fulton, AR
Ms. Ouida Wright (State Employee Member), Conway, AR
Mr. Bill Gaddy (State Employee Member), Little Rock, AR
Judge Mike Jacobs (County Employee), Clarksville, AR
Dr. John Shelnutt, Dept. of Finance and Administration *(proxy)*
Ms. Gail H. Stone (Executive Director), APERS

BOARD MEMBERS ABSENT:
Hon. Richard Weiss (Ex-Officio Member), Dept. of Finance and Administration
Mayor Steve Northcutt (City Employee), Malvern, AR
Hon. Jim Wood (Ex-Officio Member), State Auditor
Hon. Martha Shoffner (Ex-Officio Member), State Treasurer

VISITORS PRESENT:
Mr. Paul Troup, Callan Associates, Inc.
Ms. Erika Gee, Attorney General's Office
Ms. Mary Cameron, Bureau of Legislative Research
Mr. Wes Goodner, State Treasurer's Office
Ms. Karla Shepard, State Treasurer's Office
Mr. Chris Villines, Association of Arkansas Counties
Mr. Paul Young, Arkansas Municipal League
Rep. Allen Kerr, AR State Representative
Mr. Chris Burk, National Timber Partners
Mr. Andy Davis, *Arkansas Democrat-Gazette*

STAFF PRESENT:
Ms. Michele Williams, Deputy Director, APERS
Mr. Carlos Borromeo, Chief Investment Officer, APERS
Ms. Susan Bowers, Associate Director of Investments, APERS
Mr. Jay Wills, Attorney Specialist, APERS
Mr. Craig Blackard, Internal Auditor, APERS
Ms. Abbi Bruno, Retiree Services Manager, APERS
Mr. Bill Dull, Chief Fiscal Officer, APERS
Ms. Becky Walker, Administrative Service Manager, APERS
Mr. Jon Aucoin, Communications Manager, APERS
Ms. Linda McGrath, Administrative Specialist, APERS

NEWS MEDIA NOTIFIED:
A letter of notification of the Arkansas Public Employees Retirement System Board meeting was sent to the Arkansas Democrat-Gazette, the Associated Press, Television Station KLRT/FOX16, Radio Station KARN, and Radio Station KAAY. This letter of notification is pursuant to A.C.A 25-19-101 (Act 93 of 1967) as amended-The Freedom of Information Act.

INTRODUCTION OF NEW BOARD MEMBERS:
Mr. Williams pointed out that there were two new Trustees on the Board: Judge Mike Jacobs and Mayor Steve Northcutt (who had a family emergency and could not attend today's meeting). Judge Jacob explained that he was the County Judge from Johnson County and was

in his 11th term. He joked that he was looking forward to *using* the system before much longer and he was delighted to have been appointed to the board.

MINUTES:

Prior to the Board meeting, copies of the Minutes from the meetings of November 18, 2009 and February 17, 2010 were distributed to each APERS Board member for review. On a motion made by Mr. Gaddy and seconded by Mr. Henry, the Minutes were approved as presented.

QUARTERLY REPORT FOR THE PERIOD ENDING MAY 31, 2010 - Presented by Mr. Paul Troup of Callan Associates, Inc.

Mr. Troup drew the Board's attention to the new section of the Callan quarterly report, the Capital Market Review, which describes one of the three factors that affects the investment environment. He summarized the March quarter as one in which small domestic equity managers outperformed their larger counterparts, Value outperformed Growth and finally, the "trash stock" rally continued to plaque high-quality investors. Returns in the International market were much more modest due to the strengthening dollar. For the twelfth-straight month Government Bonds had a difficult time against High Yield or Mortgage-backed Assets.

The Actual Asset Allocation is very close to the Target Allocation, with the exception of a slight underweight in the Alternatives class.

Mr. Troup pointed out that the J&W Seligman portfolio had been liquidated since the last meeting, with most of its assets going into the Mellon S&P 500 Index fund. He also showed the Trustees how the International monies formerly invested with Tradewinds had been placed in the International Index fund until a replacement manager could be selected. Artisan Partners had received it $147 million funding in January 2010. Finally, Pinnacle used an additional $6 million it had requested from the Board to purchase more timber during the March quarter.

APERS currently employs four managers who utilize quantitative investment strategies: Golden, INTECH, INVESCO and SSgA. Mr. Troup stated he would discuss the how quantitative managers have been recently disadvantaged later in the presentation.

Thanks to the strong U.S and International stock markets the fund grew by 34.66% over the past 12 months and finished close to the top third when ranked against other public funds. Mr. Troup explained that the fund was still 21% behind where it was at its high in 2007. Despite compounding money over the last five years at a rate of 4.67%, the fund is still not satisfying its actuarial requirement.

Mr. Troup picked out the U.S. and International Equities managers for further scrutiny on why they had failed to return more than their benchmarks. For the last twelve months, the domestic equity portfolio has returned 50.92% yet it lagged its benchmark and finished in the bottom third of other public funds. Much of that underperformance came during the last two quarters due to what Mr. Troup called a "quality malaise".

For the last six months that APERS has had Golden Capital in the portfolio it has lagged behind its benchmark. Mr. Troup reminded the Board that Golden was one of the four Quantitative mangers in the portfolio, and they over weighted their portfolio with high quality stocks. This was precisely the type of manager who would be most disadvantaged with the "quality malaise" over the past half-year. He pointed out that the APERS Board had never had a presentation from Golden, since they were a carryover from the ASPRS investment program, and he felt it would be prudent for the Trustees to hear from Golden at the August meeting.
Mr. Troup suggested that they be asked to address the issues of if their process still functioned and if their long-term, high-quality stock factors could still deliver better than market results.

He explained that Callan could provide a statistical measurement for how long it will take Golden to make up a 1.4% deficit, as the longer it continues, the higher the differential and the lower the probability it is that Golden will emerge as a winning manager. INTECH and INVESCO both suffered similarly due to the "quality malaise" but had longer track records as APERS managers.

Despite returns of 41.13% for the last twelve months, INTECH still ranked in the 85% of similar Growth Managers. INVESCO returns for the last year were almost identical. Mr. Troup felt this was further evidence of quantitative factors not necessarily providing success in this investing environment; however Callan had an additional concern regarding INVESCO in that the original team who had built the portfolio had all retired. While Callan was not as comfortable with the new team as they had been with the old one, they did not blame the team for the returns, but rather the malaise that seemed to be attacking the quantitative strategies.

Mr. Troup continued through the list of Domestic Equity managers and pointed out how many of them had been hampered by the high quality stocks they were holding. He said it was one of the few times he had ever seen so many portfolios affected by the same phenomenon.

APERS' Fixed Income portfolio, now free of the chronic underperformance of Aberdeen, placed in the top 4% of its peers for the quarter and close to the top third percent for the last twelve months.

The International portfolio, with Artisan in place for the first full quarter, returned 1.92% and 51.26% for the year. For the last twelve month, it lagged behind the index by more than 3%, but now that APERS' full International portfolio was in place, Mr. Troup was optimistic the strong performances would continue.

Dr. Shelnutt questioned what amount of exposure the portfolio had to European Banks in light of the financial problems in Greece, France and Germany? Mr. Troup agreed that was an excellent question. He would research it and get back to the Trustees with a definite answer.

Mr. Troup reminded the Board that the British Petroleum (BP) crisis in the Gulf of Mexico had damaged the price of many energy stocks, so Callan was not surprised to see poor returns for the quarter in the Global Energy portfolio.

The largest negative numbers in the portfolio came in the Alternatives portfolio. Fortunately, INVESCO had taken most of their write-downs early. Consequently, their performance was slightly less-negative than their peers. He cautioned that the Trustees should not expect much improvement for at least another 6-12 months.

Mr. Gaddy asked if it was possible to get an annual performance ranking of how APERS ranked against the other states. Ms. Stone stated that NASRA did a "Roll Call of the States" each August at their annual meeting and at the 2009 meeting APERS was solidly in the middle of the rankings with a ~20% loss.

There was a short discussion on Defined Benefit/Defined Contribution plans and Mr. Troup stated that the State of Florida had become the best case study for the effects of lobbying and pension plans dealing with Defined Contribution to date. Ms. Stone commented that the Florida DC plan required 30% enrollment in order to be profitable, but only managed to subscribe about 3% of the available participants.

INTECH & Quantitative Manager Review

Mr. Troup directed the Board's attention to a Callan memo in their handout folder. He reviewed the history of APERS regarding the hiring of quantitative managers beginning with INTECH. Since they were hired in 2004, INTECH has had disappointing returns. At this juncture in time, the question could be asked "Is INTECH an ineffectual manager or is this reflective of a difficult period for quantitative managers in general?" Using information from Callan's database, Mr. Troup showed the Trustees how quantitative managers in general have performed in line with fundamental stock-picking managers over longer periods of time (10 years). He cautioned that this did not mean all the quantitative mangers should be given a free pass and pointed out that Golden and INTECH used totally different processes. He suggested that the Trustees request a meeting with Golden at the August meeting since most of the Board members had not sat through a presentation by this manager.

Mr. Troup also recommended that the Trustees recall INTECH at the same time. He felt that when they were last before the Board, they did a poor job setting expectations and explaining what they did correctly. He didn't mean to imply that they were a bad manager, but he understood how important it was for the Trustees to understand the process that this manager used. Mr. Troup realized that this would make the August meeting a lengthy one, but he felt that INTECH owed the Board a better explanation of their investment process.

Mr. Henry motioned for INTECH to give a formal presentation to the Trustees during the August 18th meeting. Motion carried unanimously.

Golden Investment Guidelines – Draft

Mr. Troup explained that Staff had crafted Investment Guidelines for Golden and he briefly reviewed it with the Board members. It detailed how and what they will report to the Board each quarter. Ms. Wright motioned for approval of the guideline and Mr. Henry seconded. Motion passed.

Lazard International Investment Guidelines – Draft

The Lazard International portfolio is currently benchmarked against the MSCI ACWI ex-US index which currently contains an 18% Emerging Market exposure. The original guidelines limited Lazard to 25% outside the EAFE. They pointed out that since the EM exposure in their benchmark moves over time, rather than have a static 25% Lazard requested that their target move with the benchmark. What they were requesting was floating limit up to 125% of the target and the policy has been altered to reflect this request. Callan and Staff had discussed this modification and thought it was a good idea.

Mr. Gaddy motioned to adopt the modified investment guidelines for Lazard International. Mrs. Wright seconded and the motion carried

Minority Vendor Policy - Draft

Mr. Troup explained that this document puts into written form, practices that are already in place and reflects the Governor's initiatives to include qualified minority firms in the Arkansas programs. When hiring a fund manager, one needs to ensure that minority money management firms are considered. Mr. Troup assured the Board that they always have been, but it has never actually been codified. Going forward, Callan promised to identify these firms and tell the Trustees where they were in the search process.

Another place it is important to acknowledge minority participation is in the transaction clearing (doing brokerage for the system). APERS has had a full discretion policy by the money managers to do "best execution" on behalf of the retirement system. Callan has asked the managers to identify with whom they did brokerage and capture the minority brokerage firms that they did business with and to what amount. Mr. Troup pointed out that this will be reported as "Total transaction and commission activity cleared through minority, female and disabled-owned broker/dealers."

Judge Jacobs motioned to approve this document's inclusion into the APERS Investment Guidelines. He was seconded by Ms. Wright and the motion passed unanimously.

Burns Park Construction Loan

Ms. Stone explained this opportunity to fund a construction loan had been presented to Staff to build a lodge and family activity center in Burns Park for $31 million. Staff felt that since this was a construction loan, which are inherently fraught with dangers, as well as a "take-out" loan, it didn't warrant being brought before the Board. Ms. Stone stated that prior to the System's hiring an investment expert, the guidelines specifically prohibited construction loans, since they were not really "investments" but true loans. She pointed out that when Staff could currently get 12-18% in Fixed Income, why should the Trustees consider risking money for merely a bank rate. The only reason she felt it warranted attention by the Board was the fact that it was an Arkansas-specific request but cautioned that it failed so many hurdles she doubted the Board would be inclined to get involved.

No one on the Board expressed interest in reviewing the details any further, so the Chair moved to the next item on the agenda.

SUMMARY OF RETIREES FOR MARCH, APRIL & MAY 2010 :

Ms. Stone pointed out that the number of retirees continued to grow each quarter.

MEDICAL REVIEW BOARD RECOMMENDATION:

The Medical Review Board met at 10:00 a.m. on Thursday, May 13, 20010 in the APERS Library to discuss one (1) case: Ms. Barbara Piper.

- After review and discussion, the Medical Review Board recommended the denial of disability retirement of Ms. Barbara Piper at this time, pending further information.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING MARCH 31, 2010:

Ms. Stone pointed out that under the "Changes in Plan Net Assets" during the first nine months of this fiscal year, APERS has paid out over $241 million in benefits. This amount will probably exceed $300 million by the end of this fiscal year; a record amount for the system. Staff has calculated that roughly 93% of this money stays in Arkansas.

OTHER BUSINESS:

Litigation Update – Presented by Mr. Jay Wills, APERS Attorney Specialist

Mr. Wills announced that there was no new litigation at this time and the pending appeal involving Judge Munson has still not been resolved by Judge Fox in Circuit Court. There was also the disability appeal of Mr. Larry Claibourne that has been resolved by the Circuit Court in favor of APERS. Mr. Wills stated that as of yesterday (May 18, 2010) the appeal time ran without a Notice of Appeal being filed, so he suspected the case had been resolved.

Return to Employment – Presented by Mr. Jay Wills, APERS Attorney Specialist

Mr. Wills was optimistic that the case of the improperly retired elected-officials was winding down. In total, eleven individuals were identified and two of these immediately repaid the benefits in question. Of the remaining nine, APERS has terminated six individuals' retirement benefits beginning May 1, 2010.

Mr. Wills indicated that a week ago he had spoken to Ms. Denise Hoggard, the attorney representing all but one of these individuals, and she gave no indication that any of her clients was planning on appealing the termination to the APERS Board. He commented that all of these individuals were running for re-election and he suspected that after the elections, the Board might be hearing appeals from some or all of those members. The other three individuals are still receiving benefits and Staff is waiting on further information before deciding if they had also retired incorrectly. Mr. Will felt that now that the primary elections were over, Staff should be getting the information fairly quickly to make a determination.

Ms. Hoggard has raised the issue of "Statute of Limitations" and Mr. Wills reminded the Trustees that APERS' one-year Statute of Limitations is rather peculiar in that it runs from the first inappropriate payment rather than the last payment. He believed that Ms. Haggard had raised a good argument and that was why Staff had chosen to merely stop the improper retirement payments instead of attempting to recoup the monies that had already been paid prior to a year before this issue came to light. Mr. Wills felt that attempting to recoup these losses might result in penalties on local employers for past-due employer contributions and could result in a possible improvement in the finances for some of these improperly retired individuals.

At this point in time, these six members are having their retirement benefits terminated and APERS is allowing them to keep any retirement money previously collected, but they are getting no further credit in the system and will not have their retirement benefits reinstated until they properly terminate employment.

Mr. Wills strongly advised the Board to consider legislation to change the current statute of limitations to run from the last incorrect payment, rather than the first as currently stated.

Potential Legislation

Ms. Stone stated that she'd previously sent an e-mail to all the Trustees regarding a meeting she'd had with Representative Allen Kerr, Representative Tim Summers and Mr. Jody Carreiro (Actuary for the Legislative Retirement Committee). Both Representatives expressed concerns about the viability of the retirement system after hearing horror stories of the status of other state's pension plans, specifically Illinois, New Jersey and California where the pension plans were never properly funded and are now facing huge liabilities.

Mr. Carreiro and Ms. Stone took great pains to show the gentlemen the relative health and security of APERS. However, in light of the on-going financial environment of the United States, they were interested in considering certain cost-saving measures for the system. Ms. Stone explained that she had forwarded their ideas onto the APERS' Actuaries and she had just received a response from Gabriel, Roeder, Smith & Company.

Ms. Stone stated that she had just received the actuarial cost analyses on the proposed benefit changes by e-mail the previous evening. She took the Trustees through the various changes ranging from lowering the annual cost-of-living adjustment from 3.0% to 2.7% (estimated to save the system $13.4 million annually), lowering it to 2.5% (estimated to save $21.2 million) and extending full age and service eligibility back out to 30 years ($14.9 million).

While these are decisions for the Legislature to make, Ms. Stone urged the Board if there were any that they supported or if they wished to sponsor other retirement legislation they needed to give an indication to the Governor's office by July 1st. She noted that the Board would not normally meet again prior to that date, so this was probably the only chance they would have to discuss the issue.

Mr. Henry expressed concerns that while such legislation might benefit the fund, his first impression was it required the member to work harder and get less. Ms. Stone pointed out that might be true with the reduced COLAs, but members would actually earn higher benefits working for 30 years, as opposed to 28 years.

Ms. Stone discussed several other ideas that had been brought up at a recent ATRS meeting. The first suggestion had been allowing DROP retirees to leave their money in the system and earn 4% interest, while another was moving the system back to 10-year vesting. The Trustees briefly discussed the pros and cons of both these and other related issues.

Mr. Williams asked if the other Trustees wanted to schedule a special meeting in June, but Ms. Stone pointed out that until the fiscal year closes (June 30) and until Staff gets the data back from GRS, there really was nothing more that could be added to the discussion. Mr. Williams acknowledged this and said the Board would revisit the issue at the August meeting.

Biennial Budget Presentation

Ms. Stone drew the Board's attention to a three page Budget Summary that Staff had compiled for the 2012-2013 Biennium. She was requesting a total of six new positions over the next two years. Half these new positions would be involved in expanding the call center from two to five operators (Grade C116); one in the first year and two more operators in 2013. The call center has proven to be a valuable asset by removing some of the increased volume of calls that would normally be handled by the counseling staff. Last year, counselors fielded over 10,000 calls in addition to all of their one-on-one counseling appointments. Ms. Stone hoped that by expanding the call center it would alleviate requests for more and more counselors.

Also in the second year of the biennium, Ms. Stone requested an additional Retirement Analyst (Grade C116) for the Retiree Services Section to ensure that all new retirees receive accurate and prompt annuity payments. Despite the addition of these four new positions, Staff was still requesting an additional Retirement Counselor (Grade C 117) the second year of the biennium to provide adequate services to the membership. It is estimated that the number of retirees will grow annually until the year 2020.

Finally, Staff has requested an additional Administrative Specialist II (Grade C109). This position is currently being handled using an extra help position, but they are only allowed to work 1000 hours per fiscal year and the functions need to be performed on a full time basis.

The rest of the budget requests were basically straightforward and in-line with current appropriations. Ms. Stone said there was one more item that she wanted to make the Board aware of and that was the Member Records System, which is currently 13-years old and it had started to reach the edge of its capacity and calculating ability. Ms. Stone anticipated that upgrading or moving to another platform would take approximately 6 years and could cost as much as $14 million. Strategy and planning for the transfer would begin drawing on the $4 million currently in the Professional Services budget, so she warned that she would be asking for an increase to that line item in the next biennium.

Mr. Henry moved to accept Staff's recommendation of the Biennium Budget Requests for 2012-2013. Ms. Ouida Wright seconded. Motion carried.

<u>APERS 21st Annual Investment Retreat</u>

The APERS Investment Retreat will be held on Monday, October 4th at the Capital Hotel. The one-day educational event will focus on the past and present asset allocations of the retirement system.

<u>Staff Travel Report</u>

The report was noted without comments.

<u>New Staff Introduction</u>

Ms. Stone introduced the new Chief Investment Officer for APERS: Mr. Carlos Borromeo.

<u>NEXT QUARTERLY BOARD MEETING:</u>

The next quarterly meeting of the APERS Board of Trustees is scheduled for August 18, 2010 at 9:00 a.m.

<u>ADJOURNMENT:</u>

There being no further business, the meeting was adjourned.

MR. ARTEE WILLIAMS, CHAIR	MS. GAIL STONE, EXECUTIVE DIRECTOR