

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

**Monday, October 7, 2013
11:00 a.m.
1400 West Third Street
Little Rock, AR 72201**

ATTENDEES

Board Members Present

Dr. Richard Abernathy, Chair
Jeff Stubblefield, Vice Chair
Kathy Clayton
Kelly Davis
Danny Knight*
Bobby Lester
Robin Nichols*
Wes Goodner, designee for Honorable
Charles Robinson
Peggy Gram, designee for Honorable
Charlie Daniels
Susannah Marshal, designee for Candace
Franks

Board Members Absent

Lloyd Black
Hazel Coleman
Dr. Tom Kimbrell
Deborah Thompson

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

ATRS Staff Present

George Hopkins, Executive Director
Gail Bolden, Deputy Director
Shane Benbrook, Internal Audit/Risk Mgmt.
Dena Dixson, Internal Audit/Risk Mgmt.
Mitzi Ferguson, Chief Fiscal Officer
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Clementine Infante, Staff Attorney
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Tammy Porter, Paralegal
Michael Ray, Dir. Member Services
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Internal Audit/Risk Mgmt

Guests Present

Patrick McCollough, Audit Committee Member
Aaryn McCosh, Div. of Legislative Audit
Michael Bacine, Franklin Park
P. J. Kelly, Hewitt EnnisKnupp
Chae Hong, Hewitt EnnisKnupp
Steve Singleton, ARTA

* *via teleconference*

- I. **Call to Order/Roll Call.** Dr. Abernathy, Chair, called the Board of Trustees meeting to order at 11:00 a.m. Roll call was taken. Lloyd Black, Hazel Coleman, Dr. Tom Kimbrell, and Deborah Thompson were absent.

10/7/2013
PZ

II. **Motion to Excuse Absences.**

Mr. Lester *moved* to excuse Mr. Black, Ms. Coleman, Dr. Kimbrell, and Ms. Thompson from the October 7, 2013, Board of Trustees meetings. Ms. Gram *seconded* the *motion*, and the Board *unanimously approved the motion*.

III. **Adoption of Agenda.**

Mr. Knight *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 Board Minutes.**

A. **Minutes of July 26, 2013.**

Ms. Gram *moved* for *approval* of the Minutes of the Board of Trustees meeting of July 26, 2013. Mr. Stubblefield *seconded* the *motion*, and the Board *unanimously approved the motion*.

B. **Minutes of September 4, 2013.**

Mr. Knight *moved* for *approval* of the Minutes of the Board of Trustees meeting of September 4, 2013. Mr. Lester *seconded* the *motion*, and the Board *unanimously approved the motion*.

VI. **Member Appeals.**

A. S. [REDACTED] B. [REDACTED] Laura Gilson, General Counsel, presented the S. [REDACTED] B. [REDACTED] member appeal. Ms. B. [REDACTED] is a member of ATRS that was denied disability benefits due to failure to meet the application deadline. The Hearing Officer reviewed the facts and the law and upheld the ATRS Staff Determination and the ATRS Executive Director's decision that Ms. B. [REDACTED] is ineligible for disability retirement.

Mr. Lester *moved* to *affirm* the Hearing Officer's decision in the matter of S. [REDACTED] B. [REDACTED] member appeal. Jeff Stubblefield *seconded* the *motion*, and the Board *unanimously approved the motion*.

10/7/2013
p 3

B. B. W. Ms. Gilson updated the Board on B. W. member appeal. Mr. W. appealed to Circuit Court the Hearing Officer's decision. The Circuit Court affirmed the decision of the Hearing Officer and dismissed the case with prejudice.

VII. **Report of Member Interest Waived under A.C.A. § 24-7-205.** Mr. Hopkins presented the member interest amount waived report. ATRS waives interest on 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. There were no waivers to report.

VIII. **Report of Employer Interest and Penalties Waived under A.C.A. § 24-7-411.** Mr. Hopkins presented the employer interest and penalties waived report. ATRS may waive employer interest and penalties when reports/payments are late or have issues due to new bookkeeper, sickness, etc. ATRS waived \$3,611.19 in employer interest and penalties.

IX. **Audit Committee Report.** Mr. Lester, Vice Chair, gave a report on the Audit Committee Meeting.

A. **Welcome to New Audit Committee At-Large Members.** The Audit Committee welcomed new at-large members Patrick McCollough, and Ricky Quattlebaum to the Audit Committee.

B. **Internal Audit Report: Accounts Receivable.** Internal Audit Department's audit of accounts receivable revealed that internal controls over receivables were weak. Some of the findings included reconciliations of subsidiaries to the general ledger were not done in a timely manner, subsidiaries not properly maintained and written policies were inadequate or did not exist. The findings noted go back several years. Internal Audit met with accounts receivable staff and discussed the findings that were discovered. Accounts Receivable immediately began working on Internal Audit's recommendation.

Internal Audit staff believes adequate written policies and procedures, reconciliations performed in a timely manner and subsidiaries properly maintained would also eliminate a lot of problems noted in our audit report

C. **Accounting Department's Response to Internal Audit Report: Accounts Receivable.** It will take the Accounting Department a significant amount of time to complete the clean-up of the purchase accounts. The Department is already at work making the changes and will continue researching purchase accounts.

A brief summary of the Accounting Department's response to the audit findings as follows:

- **Finding 1: Written policies and procedures were inadequate** - inadequate written policies and procedures will be addressed through the employment of extra help that is knowledgeable of processes and sound internal control procedures.
- **Finding 2: Reconciliations of subsidiaries to the general ledger are not being performed** - penalty and interest subsidiary ledgers have been reconciled to the general ledger accounts and the work to reconcile the subsidiary for employer and employee contributions receivables is in progress.
- **Finding 3: Penalty and interest subsidiary ledgers balances were not properly identified by employer** - penalties and interest subsidiary ledgers have been compiled by employer and reconciled to general ledger accounts.
- **Finding 4: Auditable population could not be determined** - reconciliation of subsidiaries to the general ledger will ensure an auditable population exists.
- **Finding 5: Receivable balances include old balances that go back several years** -the Accounting Department has prepared a spreadsheet of the old outstanding balances to present to Department of Finance and Administration for their approval to write-off the uncollectible receivables. Going forward, the Agency has new legislation (Act 448 of 2013) that enables the Arkansas Department of Education (ADE) to withhold future past due ATRS employer contributions, penalties, and interest from amounts designated to be distributed by ADE to the employer.
- **Finding 6: Inadequate audit trail**- addressing findings 1 through 5 will provide an adequate audit trail.
- **Finding 7 and 8: Interest was incorrectly calculated and inconsistently applied** - the Department will address the errors in interest calculations when the purchase accounts are researched and reconciled to the general ledger. The Department has automated their process for assessing interest on underpayments of employees' contribution. The automated process will help prevent omissions present in the manual system. Also, as members retire, their accounts are researched thoroughly and any outstanding amounts or errors are resolved.

- **Finding 9: Benefits receivable were overstated by \$22,005** - The Department made journal entries to properly reflect the collection of the amounts due.

X. **Investment Committee Report.** Mr. Hopkins, Executive Director, presented the Investment Committee report.

A. **Investment Update and Arkansas Related Update.**

1. **Woodland Heights Update.** Actual occupancy was down to 68%. Several units are newly leased and about to be occupied. When the newly leased units are occupied, the occupancy level will be 74%.
2. **Grosvenor/Credit Suisse Pending Sale Consent Issues Using Imminent Need.** Credit Suisse is an international bank and has been working with regulators to return to a more core banking business. One of the activities of Credit Suisse to satisfy regulators has been to enter into a definitive agreement to sell its private equity operation to a hedge fund manager in Chicago, called Grosvenor. Part of the process of the transfer of the Credit Suisse private equity operation to Grosvenor is that ATRS has a right to review the transfer and decide whether to consent to the change in management or not. ATRS is currently in a forty-five day window to decide whether consent is appropriate for the transaction. Grosvenor has never managed a private equity group but is known as a quality hedge fund firm.

ATRS' Credit Suisse investment is in two large private equity fund of funds. The investment was made in two separate years in two separate funds in which ATRS owns over 99% of each fund and Credit Suisse owns less than 1 % of each fund. In addition, all of the private equity managers for these two funds have already been chosen and the only issue remaining is to monitor the 48 managers within these two funds until the funds all mature and provide financial detail to ATRS. The duty for the fund of funds manager is now more to ensure compliance with the underlying manager agreements, provide oversight to the combined funds, and present ATRS with financial reports.

Although this is a private equity issue, Hewitt EnnisKnupp (HEK), not Franklin Park, is providing the consultant input on whether ATRS should consent to the manager change for two reasons. First, the Credit Suisse private equity investment, which consists of two separate fund of funds investments that had an initial combined commitment of

just over \$600,000,000 was an investment recommendation made by HEK. Second, Franklin Park has expressed an interest in providing the fund oversight services currently performed by Credit Suisse in the event that consent is not given to the sale and ATRS undertakes a different direction for the management and finalization of these funds. To prevent any conflict and for alignment of interests, it was determined by ATRS staff that it would be best for Franklin Park not to be involved in the decision on whether to consent.

ATRS staff and HEK recommend that the Board authorize the transfer if HEK and the executive director, after consultation with Dr. Abernathy, determine that consent should be given.

a. **Resolution 2013-35**

Ms. Nichols moved to adopt Resolution 2013-35, approving authority for ATRS executive director to consent or withhold consent to transfer management of ATRS' Credit Suisse fund of funds to Grosvenor with imminent need. Mr. Knight seconded the motion, and the Committee unanimously approved the motion.

3. **Manager Terminations, Investment Maturities, and Changes Update.**

- a. **Halderman Change Update.** At the June 3, 2013, Board meeting, the Board approved assignment of the farm management agreement from Halderman Farm Management Services, Inc. (HFMS) to Halderman Real Asset Management, LLC (HRAM). The reason for the change was for regulatory compliance registration due to the nature of clients such as ATRS. The assignment was executed on June 30, 2013, and the transaction is now complete.
- b. **Department of Education Loan Pay-Off Update.** The Department of Education loan was paid off in full in May 2012. The 8% interest, 15-year promissory note returned \$23,720,698 in interest income, in addition to the entire principal due of \$24,825,000.
- c. **BTG Pactual – Acquisition of Regions Timberland Group.** At the June 3, 2013 Board meeting, Resolution 2013-18 was passed approving the assignment of the timber management contract from Regions Bank to BTG Pactual Asset Management US, LLC. The transaction was finalized on September 6, 2013, and

established BTG Pactual as the largest timberland manager in Latin America and one of the largest worldwide, with committed and invested assets of nearly US \$3 billion and a portfolio of over 1.77 million acres across the USA, Latin America, Europe, and South Africa. The management group's new name is BTG Pactual Timberland Investment Group, LLC. The approved transaction is now complete.

4. **Emerging Manager Report.** In the 2013 legislative session, a bill was passed, now Act 304 of 2013 that requires ATRS consultants to include an annual report to ATRS on activities undertaken to find, vet, and consider hiring emerging managers as defined by Arkansas law. Although the reports are not required until next year, HEK and Franklin Park each provided reports this year.

B. General Investment Consultant Update – Hewitt EnnisKnupp.

1. **Portfolio Performance Update for the Quarter Ended June 30, 2013.** The total fund had a return of 0.7% for the quarter ending June 30, 2013, underperforming its benchmark of 1.4%. The ATRS fund yielded a 14.3% return for the fiscal year ended June 30, 2013. This return did not include the last quarter returns for private equity and real estate. This is typical for these funds to trail by one quarter. ATRS ranked in the 7% percentile of similar sized pension plans across the U. S. Global equity, fixed income, private equity, and alternative investments all outperformed the benchmarks for their asset classes.
2. **Portfolio Performance Update for the Month Ended August 31, 2013, Preliminary.** The total fund had a return of -1.3% for month ending August 31, 2013, outperforming its benchmark of -1.5%. All asset classes outperformed their bench marks, though the fund performed at a loss for the month.
3. **Allianz Structured Alpha Recommendation.** As of July 31, 2013, ATRS had approximately \$466 million invested in the Allianz Structured Alpha US Equity 250 product. This investment was initially made by ATRS in early 2008 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. Performance of the strategy since inception has been strong and the volatility of the return has declined due to enhancements made to the process. HEK and staff recommended transferring \$100 million of the current investment of approximately \$466 million in the 250 fund to the 500 fund, which

has higher tracking error to the S&P 500 Index and a greater potential for value added.

The 500 fund will be a separate fund in which some of the 250 fund investments can be transferred to minimize transition costs. Since the 500 fund is a separate and distinct fund, a new set of legal documents will need to be reviewed and executed by ATRS. HEK recommends moving the existing Allianz Structured Alpha U. S. Equity 250 fund into a separate Allianz Structured Alpha U. S. Equity 500 fund.

a. Resolution 2013-36

Ms. Nichols *moved to adopt* Resolution 2013-36, approving partial transfer of up to \$100 million of Arkansas Teacher Retirement Assets from Allianz Structured Alpha U.S. Equity 250 L.L.C. to Allianz Structured Alpha U.S. Equity 500 L.L.C. Mr. Knight *seconded the motion*, and the Committee *unanimously approved the motion*

C. Real Assets Investment Consultant Update – Hewitt EnnisKnupp.

1. **Real Assets Performance Report for the Quarter Ended June 30, 2013.** NFI-ODCE (the net benchmark) returned 3.6% for quarter ending June 30, 2013, an increase of 120 bps over 1st quarter results. ATRS' real asset portfolio is currently 12.5% allocated and is progressing towards its target allocation of 15% of the total ATRS portfolio. The recent dip in the timber value was due to lower appraised values in the Virginia and Arkansas holdings, but still positive for the trailing year.
2. **Changing From Real Estate Investment Policy to Real Assets Investment Policy.** In the June 3, 2013, Board meeting, the Board approved a revised general investment policy that included an allocation to real assets. HEK proposes a real assets investment policy that provides guidelines on real estate, timber, agriculture, and infrastructure. The proposed real assets investment policy is to complement the general investment policy and provide more detailed real asset policy guidance on matters such as performance benchmarks, portfolio composition, risk management, roles and responsibilities
 - a. **Proposed Real Assets Investment Policy.** The changes included a transition from a real estate class to a real assets class. Most of the changes relate to benchmarks that more appropriately track

how well ATRS investments are doing relative to industry standard benchmarks.

- b. **General Investment Policy Changes to Implement Real Assets Investment Policy.** The changes are to make the general investment policy conform to the new real asset policy. No other changes were being made.

Ms. Nichols *moved to approve* the proposed changes to the real estate investment policy and the general investment policy to implement the real assets investment policy. Mr. Knight *seconded the motion*, and the Committee *unanimously approved the motion*.

3. **Recommendation to Commit up to \$50 Million to UBS Agrivest, Comingled Agriculture Fund.** This is a diversified, open-end fund that targets equity investments in low-risk farmland properties across the U.S. Properties are wholly-owned and then leased to commercial farm operators, rather than directly operated by Agrivest. This strategy serves to lower the fund's exposure to commodity price risk or crop failure. The fund is expected to exceed the core farmland index while also targeting a 5% real return over inflation. Over the long-term, this fund is expected to provide an attractive, low-risk exposure to the U.S. commercial farmland market. HEK and ATRS staff recommend a commitment of up to \$50 million

- a. **Resolution 2013-37.**

Ms. Nichols *moved to adopt* Resolution 2013-37, approving the recommendation to commit up to \$50 million to UBS Agrivest, Comingled Agriculture Fund. Mr. Knight *seconded the motion*, and the Board *unanimously adopted the resolution*.

4. **Recommendation to Cap Remaining Timber Land Commitment.** The timber land portfolio has grown to \$348 million, which represents approximately 2.7% of ATRS' total assets as of June 30, 2013. This is slightly above the general 2% timber allocation as detailed in the real assets investment policy. There is approximately an additional \$24 million available to be called for new timber investments under an allocation made at the December 6, 2010, Board meeting.

Due to the weakness in demand for fiber for paper and timber for building materials, HEK and ATRS staff recommend no further

deployment of the remaining \$24 million timber allocation. The Committee clarified that the executive director, Board Chair, and HEK are to bring compelling investments from BTG Pactual if the opportunity arises. HEK and ATRS staff concurred.

Ms. Nichols moved to approve the recommendation to cap the remaining timber land commitment. Mr. Knight seconded the motion, and the Committee unanimously approved the motion.

5. **Halderman Farmland Management Agreement Amendment Re: Single Investment Limitation.** Two changes have been made to the Halderman Farmland Management agreement. The first cleaned up language that implied ATRS directed the hedging program. The second allows for a single asset to exceed the 20% limit of the entire portfolio net asset value subject to ATRS approval. This item was included as a notice to keep the Board informed of changes that are being made.

D. Private Equity Consultant Update – Franklin Park.

1. **Private Equity Portfolio Review for the Quarter ended June 30, 2013.** The Net IRR for the aggregate portfolio since inception was 9.25% for the combined legacy and post 2006 portfolios. The percentage change in portfolio value for the quarter was a positive 3.7%

XI. **Operations Committee Report.** Mr. Bobby Lester, Operations Committee Chair, presented the Operations Committee report.

- A. **Open Forum for Potential Rule or Law Changes by Committee Members and Board Members in Attendance.** The Operations Committee had the opportunity to discuss potential rule or law changes.

Mr. Stubblefield discussed disability retirement and ATRS' authority to re-evaluate disability retirees. The Committee discussed potential methods to verify if disability retirees return to work for non ATRS covered employers. The Committee asked Mr. Hopkins to work with staff to develop procedures for pursuing retirees who have gone back to work for non ATRS covered employers and methods to increase scrutiny and monitoring.

B. Potential Legislation.

1. **De Minimis Amount.** Mr. Hopkins discussed potential legislation regarding de minimis amount. ATRS attempted to place a \$25.00 de minimis amount in the proposed rules that are currently in the approval

process. ATRS currently has variable de minimis amounts in the existing rules. Legislative staff questioned the authority for ATRS to set de minimis amounts for what members and employers owe ATRS, what ATRS might owe an employer, or what a member or beneficiary may owe ATRS. At certain levels, the cost to process financial transactions exceeds the amount involved. ATRS rules currently have de minimis amounts varying from \$10.00 to \$25.00. Potential legislation will likely be requested in the 2015 session.

XII. Staff Reports.

A. Medical Committee Reports. Mr. Ray presented the Medical Committee reports for August 2013 and September 2013. In August 2013, there were 12 applicants, 10 were approved, and two needed more information. In September 2013, there were 18 applicants, 17 were approved, and 1 needed more information.

Mr. Lester *moved to approve* the August 2013 and September 2013 Medical Committee reports. Ms. Gram *seconded the motion*, and the Board *unanimously approved the motion*.

XIII. Applications for Pending Board Vacancy Position #2. Mr. Hopkins presented the applications for pending Board vacancy for Position #2. The Board has the authority to fill vacant Board positions by appointment for member Trustees.

XIV. Executive Session to Discuss Filling Pending Vacancy on Board Position #2. Chair, Dr. Abernathy, called the Executive Session of the Board of Trustees to order at 11:22 a.m.

Chair, Dr. Abernathy, reconvened the Board of Trustees meeting at 11:24 a.m.

XV. Potential Appointment of Trustee to Fill Unexpired Term for Member Position #2 due to Pending Vacancy.

Mr. Lester *moved to appoint* Janet Watson to the pending vacant Trustee Position #2. Mr. Knight *seconded the motion*, and the Board *unanimously approved the appointment*.

XVI. Other Business. None.

XVII. Adjourn.

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

Meeting adjourned at 11:26 a.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Tammy Porter,
Recorder

Date Approved