MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES

Monday, December 7, 2015
1:00 p.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
Bobby Lester
Robin Nichols
Deborah Thompson
Janet Watson
Honorable Andrea Lea

Board Members Absent
Candace A. Franks
Johnny Key

Guest Present
Donna Morey, ARTA
Chris Caldwell, Div. of Legislative Audit
Judy Kerman, GRS
Brian Murphy, GRS
P.J. Kelly, AHIC (Aon Hewitt)
Katie Comstock, AHIC (Aon Hewitt)
Chae Hong, AHIC (Aon Hewitt)

ATRS Staff Present
George Hopkins, Executive Director
Gail Bolden, Deputy Director
Shane Benbrook, Internal Audit/Risk Mgmt.
Curtis Carter, Chief Fiscal Officer
Vicky Fowler, Dir. Human Recourses
Laura Gilson, General Counsel
Rod Graves, Assoc. Dir. of Operations
Wayne Greathouse, Assoc. Dir. of Investments
Willie Kincade, Retirement Sec. Manager
Mike Lauro, Information Systems Manager
Jerry Meyer, Manager, Real Assets
Tammy Porter, Administrative Assistant
Mike Ray, Dir. Member Services
Joe Sithong, Software Support Analyst
Leslie Ward, Manager Private Equity
Brenda West, Internal Audit/Risk Mgmt.

Reporters Present
Mike Wickline, Arkansas Democrat Gazette

I. **Call to Order/Roll Call.** Mr. Jeff Stubblefield, Chair, called the Board of Trustee meeting to order at 1:01 p.m.. Roll call was taken. Ms. Franks and Mr. Key were absent.

II. **Motion to Excuse Absences.**

Ms. Nichols *moved* to *excuse* Ms. Franks and Mr. Key from the December 7, 2015 Board of Trustees meeting. Mr. Lester *seconded* the *motion*, and the Board *unanimously approved the motion.*

III. Adoption of Agenda

Mr. Knight *moved* for *adoption* of the Agenda. Ms. Davis *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 October 5, 2015.

Dr. Abernathy *moved* for *approval* of the Minutes of the Board of Trustees meeting of October 5, 2015. Ms. Nichols *seconded* the *motion*, and the Board *unanimously approved the motion.*

VI. Preliminary Active Actuarial Valuation. Judy Kermans and Brian Murphy of Grabriel, Roeder, Smith & Co., gave a presentation of the preliminary active actuarial valuation for the 2014-2015 fiscal year.

ATRS went from 77% funded on June 30, 2014 to 80% funded on June 30, 2015.(On an unsmoothed basis, ATRS is now 83% funded). The estimated amortization period that exceeded 39 years on June 30, 2014 was reduced to 33 years on June 30, 2015. On an unsmoothed basis, ATRS is well below a 30 year amortization. ATRS also has an unrealized gain of $602 million dollars to be realized over the next three (3) years.

These numbers indicate that ATRS is heading in the right direction. The bottom line is that ATRS remains strong, and the cost-cutting measures that have been the nucleus of the last three (3) legislative sessions have and will continue to help restore the system's financial condition.

VII. Statement of Financial Interest. Mr. Hopkins reminded the Board members that their Statement of Financial Interest filings are to be filed with the Secretary of State's office by Sunday, January 31, 2016, for financial information for calendar year 2015.

VIII. Proposed 2016 Board of Trustees Schedule. The Board reviewed the proposed schedule.

> **Mr. Knight *moved* to *approve* the 2016 Board of Trustee Schedule. Ms. Nichols *seconded* the *motion*, and the Board *unanimously approved the motion.***

IX. Report of Member Interest Waived Under A. C. A. Section 24-7-205. Mr. Hopkins presented the member interest amount waived report. ATRS waives interest 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. No member Interest was waived this reporting period.

X. Report of Employer Interest and Penalties Waived Under A. C. A. Sec. 24-7-411. Mr. Hopkins presented the employer interest and penalties waived report. ATRS may waive employer interest and penalties when reports/payments are late or have issues due to new bookkeeper, sickness, and other situations that justify a waiver. ATRS waived Four (4) employer penalty amounts for this reporting period in the amount of $1,650.00. Seven (7) employer interest assessments were waived for this reporting period in the amount of $362.27.

XI. Manifest Injustice Report. Mr. Hopkins presented the Manifest Injustice report to the Board. The Manifest Injustice Committee reviewed 5 cases and 4 were found to constitute manifest injustices since the last Board report on June 1, 2015. This is the second report of 2015.

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

A. Investment Update and Arkansas Related Update.

1. List of Fund Closings.

a. Redeployment, as Approved by ATRS Board, of Approximately $500 Million Dollars of the Approximately $600 Million Dollars Currently Invested in Allianz Structured Alpha Fund Investments to AllianzGI Structured Alpha Global Equity Fund. At the June 1, 2015, regular meeting, the Board authorized redeployment of up to $550 million dollars from a domestic based options strategy to a global based options strategy. The redeployment was negotiated and closed on September 28, 2015. Funds totaling $500 million dollars were transitioned into the new global strategy on October 1, 2015. The variance in the actual amount transferred from the approved amount to transfer was due to market conditions during the period that reduced the overall fund size so the amount deployed remained proportional to the original recommendation.

b. **Mandate Change, as Approved by ATRS Board, in the Voya Absolute Alpha S&P 500 Trust Fund from U.S. Equity to Global Equity and Change of the Strategy Name to the Voya Absolute Alpha Morgan Stanley Capital International (MSCI) All Country All World (ACWI) Trust Fund to Reflect the Change in the Strategy from a U.S. Only Equity Strategy to a Global Equity Strategy.** The Board authorized a mandate change and name change for approximately $185 million dollars from the domestic based Voya Absolute Alpha S&P 500 Trust Fund to the global based Voya Absolute Alpha MSCI ACWI Trust Fund. The final agreement was negotiated, accepted, and closed on November 10, 2015.

c. **Trian Partners, L.P. (Public Market Activist Manager Focused on High Quality Mid to Large Cap Companies with Sustainable Business Models and Strong Cash Flows, the Board Authorized Commitment of up to $ 50 Million Dollars in the Five Year Option was Accepted and Closed on November 2, 2015).** The ATRS full commitment of $50 million dollars was negotiated, accepted, and closed on November 2, 2015.

d. **Trian Co-Investment Opportunities Fund, L.P. (Public Market Activist Manager Focused on High Quality Mid to Large Cap Companies with Sustainable Business Models and Strong Cash Flows, the Board Authorized Commitment of up to $ 100 Million Dollars was Accepted and Closed on November 18, 2015).** The ATRS full commitment of $100 million dollars was negotiated, accepted and closed on November 18, 2015.

e. **American Industrial Partners Capital Fund VI, L.P., a Private Equity Buyout, Turnaround and Distressed**

Debt Fund that will Target Middle Market Underperforming Companies in the Industrial Sector, the Board Authorized Commitment of up to $25 Million Dollars on September 2, 2015. $20 Million Dollars of the $25 Million Dollars Recommended Allocation was Obtained on September 30, 2015. Due to high demand for this fund the General Partner would not accept the entire ATRS commitment. ATRS was able to invest $20 million dollars of the $25 million dollars authorized. The final agreement was negotiated, accepted, and closed on September 30, 2015.

f. **JFL Equity Investors IV, L.P., a Private Equity Buyout Fund that Invests in the Defense, Aerospace and Maritime Industries and Related Businesses, the Board Authorized Commitment of up to $30 Million Dollars on October 5, 2015 was Accepted and Closed on October 23, 2015.** ATRS has closed on this investment. The final agreement was negotiated, accepted, and closed on October 23, 2015 for the full requested allocation of $30 million dollars.

2. **Timber and Farmland Update**

a. **BTG Pactual Update**

1. **Completed Necessary Revisions to the BTG Pactual Investment Management Agreement to Merge Funds and to Clarify the Use of Leverage and Recallable Distributions.** At the June 22, 2015, called meeting the Board approved motions to concur with recommendations from ATRS staff, Aon Hewitt Investment Consulting, and BTG Pactual to clarify three items in the BTG Pactual Investment Management Agreement. The amended agreement combines the two portfolios, American Timberland LLC and American Timberland II LLC, and should help reduce the expense of maintaining two LLCs by eliminating the need for separate auditing and legal requirements for each. The agreement also clarifies a 20% limit on the use of leverage by BTG Pactual in the portfolio. The use of leverage will benefit ATRS by allowing any unneeded cash from

the loan to be deployed to other areas of the portfolio and also help bring the timber allocation in line with the target of 2% of ATRS assets. Finally the revisions allow the use of recallable distributions for funds managed by BTG Pactual. In other more direct investments by ATRS, 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 projects as needed (versus having the currently unneeded capital held by outside management) helps enhance ATRS returns since ATRS will have immediate use of the distributions for investments and liquidity needs. The amended agreement was executed on September 14, 2015.

2. **BTG Pactual Closed on a $70 Million Dollar Loan at a 3.86% Fixed Interest Rate for a 20 Year Term with Proceeds Returned to ATRS for Investments.** After the execution of the amended agreement, on November 23, 2015, BTG successfully negotiated and closed a loan of $70 million dollars with a term of 3.86% fixed rate interest for 20 years. In addition, due to recallable distributions, BTG was able to return approximately $32 million dollars of additional cash to ATRS. The cash had been held in reserve to allow for potential purchases but is now free for other uses by ATRS by making the distribution recallable. The Board's concurrence and clarification to allow leverage and recallable distributions to the timberland investments resulted in over $100 million dollars distributed to ATRS for liquidity and to fund investment opportunities in other asset classes. The investment opportunities that can be funded by the distributions are expected to generate a return well over the interest rate charged for the loans and should help enhance the overall return of the ATRS portfolio.

b. **ATRS Farmland Investment Concurrence.** Beginning in 2010, ATRS made a series of commitments totaling

$100 million dollars to farmland investments through Halderman Real Assets Management (HRAM). The net asset value of farmland managed by HRAM is approximately $101 million dollars which represents 0.7% of the total ATRS fund.

1. **Recommendation to Clarify Leverage on Funds Managed by Halderman Real Assets Management.** The Halderman Real Assets Management agreement provides HRAM the ability to borrow funds in connection with the ATRS farmland investments to derive additional sources of revenue. Leverage is used throughout the investment world to enhance returns and achieve important goals. ATRS staff and HRAM prefer for the existing right to leverage the farm portfolio be more specific and limited. The use of a small amount of leverage would be beneficial in providing another potential source of revenue to ATRS by allowing borrowed funds to purchase farm assets and freeing cash to be deployed in other investments that most likely would provide a rate of return above the interest rate charged on the borrowed funds. In addition, leverage will allow the manager to buy additional farmland assets as deal flow occurs. The leverage allows ATRS, through the manager, to borrow funds at very low interest rates and deploy the funds into strong returning allocations like private equity, real assets, equities, and for liquidity to pay benefits. This prudent use of leverage would be beneficial to ATRS as it would free capital, at a low interest rate, that could be deployed to other asset classes that should generate a rate of return above the charged interest rate. At this time, it appears that a borrowing at 20% leverage would be at a similar rate and term as the timber loan with interest only due for much of the term. The expected interest rates and expected terms should add value to ATRS. Any overall return above the borrowing interest rate adds positive income to ATRS. This also allows the farm manager to add more farm assets by increasing the value of farmland that

can be purchased without exceeding the approved capital commitment.

Both ATRS staff and Aon Hewitt Investment Consulting support the use of leverage to help with the farmland allocation, diversification, and returns of the farm portfolio. Both ATRS staff and Aon Hewitt Investment Consulting are comfortable with a 20% limit to the amount of leverage that can be applied to the farmland portfolio.

Ms. Nichols *moved* to *approve* the Recommendation Clarify Leverage on Funds Managed by Halderman Real Assets Management. The Board *unanimously approved* the *motion.*

2 **Recommendation to Allow Recallable Distributions for Funds Managed by Halderman Real Assets Management.** HRAM currently holds cash generated from investments in reserve to allow for the purchase of diversified properties for the portfolio. In 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. Currently, the farmland management agreement does not include the ability to recall a distribution once it is made.

ATRS requested, effective December 7, 2015, to make distributions from HRAM recallable by HRAM, with consent of ATRS staff and positive Board Chair notice. This includes the reinvestment of returns from dividends, distributions, return of capital, interest, tax credits payments, and other payments that arise from farm investments similar to other investments that ATRS has such as the American Center, Almanac V, Almanac VI, Big River Steel, Blackstone, BlueOak, BTG Pactual, Carlyle VII, Franklin Park Co-Investment Fund, Franklin Park Venture Fund 2014, KPS III, Levine Leichtman, Atlas II, Lime Rock III, and Vista Foundation II.

Ms. Nichols *moved* to *approve* the Recommendation to Allow Recallable Distributions for Funds Managed by Halderman Real Assets Management. The Board *unanimously approved* the *motion.*

3. **Arkansas Related Update**

a. **Victory Building Update: 96% Occupied, UAMS Lease Expected to Begin in April 2016, Remains a Core Asset.** The Victory Building is at 96% occupancy. US Senator John Boozeman's office was moved from the plaza level to a 2nd floor space to accommodate a 5551 square foot UAMS primary care clinic. The clinic will serve state employees as well as the general public. The lease is estimated to begin April of 2016 for a ten year term. The Victory Building continues to be a highly regarded office building in the Little Rock market and remains a core asset for ATRS.

B. Private Equity Consultant Report. Franklin Park

1. **2016 Private Equity Pacing Schedule.** Michael Bacine of Franklin Park presented the 2016 pacing schedule for private equity. Typically, ATRS has been pacing up to 2% of its underlying value for private equity for the next calendar year. Based upon assumptions of the projected market value of total assets for the next ten years, Franklin Park and ATRS staff recommend private equity pacing of $275 million dollars for 2016 in order to maintain a 10% allocation to private equity. The total pacing amount includes a $25 million dollar allocation to the Franklin Park Venture Fund 2016, and a $25 million dollar allocation to the Franklin Park International Fund 2016. Also

included is an allocation of $35 million dollars to the ATRS/FP Private Equity Fund (formerly the "Franklin Park Co-Investment Fund"). The ATSR/FP Private Equity Fund will target to invest $25 million dollars in approximately five to seven co-investment deals and $10 million dollars in one or more next-generation manager funds. Franklin Park also expects to commit approximately $30-60 million dollars in one or more debt/distressed asset funds as well as a total of $130-160 million dollars in four to six funds with buyout, growth equity, or turnaround strategies. If an additional commitment to the ATRS/FP PE Fund becomes necessary due to very robust deal flow, then Franklin Park may request that the ATRS Board use some of the allocation for direct investments to increase the allocation to the this fund. These targets are subject to availability of quality investments and prevailing market conditions. Actual amounts may vary as pacing is subject to change over the year according to available investment opportunities.

1. **Small/Mid Buyout/Growth/Turnaround $35 Million Dollars.** These are funds that seek to acquire controlling interests in companies. This is an allocation for one of these funds at a $35 million dollar level.

2. **Small/Mid Buyout/Growth/Turnaround $35 Million Dollars.** These are funds that seek to acquire controlling interests in companies. This is an allocation for one of these funds at a $35 million dollar level.

3. **Small/Mid Buyout/Growth Turnaround $30 Million Dollars.** These are funds that seek to acquire controlling interests in companies. This is an allocation for one of these funds at a $30 million dollar level.

4. **Small/Mid Buyout/Growth/Turnaround $30 Million Dollars.** These are funds that seek to acquire controlling interests in companies. This is an allocation for one of these funds at a $30 million dollar level.

5. **Debt/Distressed Assets $30-60 Million Dollars.** These funds lend money at higher interest rates to companies with liquidity needs. These managers also purchase the debt obligations of a company at or below actual value using specialized skills. The purpose of the purchase of debt can be to make interest, get the value from the discount price of the debt, or to obtain the company's equity after a default on the debt. This is an allocation for one or two of these funds at a $30 million dollar level.

6. **Franklin Park Venture Fund Series 2016 $25 Million Dollars.** This allocation is explained below in item E.

7. **Franklin Park International Fund 2016 $25 Million Dollars.** This item is explained below in item F.

8. **ATRS/FP Private Equity Fund (Co-Investment Fund) $65 Million Dollars.** This item is explained below in item G.

Ms. Nichols *moved* to *approve* the 2016 Pacing Schedule of $275 Million Dollars in Private Equity. The Board *unanimously approved* the *motion.*

2. **Recommendation to Commit up to $30 Million Dollars in DW Healthcare Partners IV, L.P., a Private Equity Buyout Fund that Invests in Expansion Stage Companies in the Healthcare Sector.** DW Healthcare Partners was formed in 2002 and is based in Salt Lake City and Toronto. The current team is comprised of Andrew Carragher, Jay Benear, Lance Rudd, Doug Schillinger and Rod Boone who average over eleven years each with the general partner. The firm has a history of successful investments in small healthcare companies and the team has substantial healthcare industry experience including executive roles, consulting and financial operations. ATRS invested in the firm's third fund which has generated a net IRR of 13.4% as of December 2014.

The fund will target control oriented investments in the healthcare sector and will focus on growth buyouts of specialty device manufacturers, product manufacturers, as well as distributors and services businesses. Typically, the fund will target companies seeking institutional capital for the first time and will purchase at conservative prices and leverage multiples. Most companies will provide essential patient care or treatment and will have opportunities for operational improvement and organic or add-on growth. The general partner's dedicated deal sourcing resources include a database of over 24,000 healthcare companies. This and other resources have led to significant deal flow for the firm over the course of the last three funds.

a. Resolution 2015-32

Ms. Nichols ***moved*** **to** ***adopt*** **Resolution 2015-32, to Commit up to $30 Million Dollars in DW Healthcare Partners IV, L.P., a Private Equity Buyout Fund that Invests in Expansion Stage Companies in the Healthcare Sector. The Board** ***unanimously adopted*** **the** ***resolution.***

3. Recommendation to Commit up to $30 Million Dollars in PineBridge Structured Capital Fund III, L.P., a Small and Middle Market Mezzanine Debt and Equity Securities Fund. Headquartered in New York, PineBridge is a global asset management firm that manages capital across various public equities, fixed income and private equity strategies. The firm is a majority-owned subsidiary of Pacific Century Group ("PCG"), a private investment group. Prior to the firm's sale to PCG in 2010, it was part of AIG. PineBridge's broader investment activities do not appear to overlap or conflict with this fund's strategy. The fund will be managed by two senior investment professionals, F.T Chong and Scott Gallin who average fifteen years each with the general partner and fifteen years of private equity experience.

The fund is being formed to make structured capital investments in mezzanine debt and preferred equity securities that are structured with contractual coupons or dividends generating 12-16% yields with equity upside potential. Typically this type of private equity investment carries less risk than other types but has somewhat lower returns. The manager will employ low levels of financial leverage in their transactions as well, and that will help mitigate any downside risk. Since 2000, the general partner has generated approximately 16% net IRR on its previous investments of this type. Both Franklin Park and ATRS staff recommend an investment of up to $30 million dollars in PineBridge Structured Capital Fund III, L.P.

a. Resolution 2015-33

Ms. Nichols ***moved*** **to** ***adopt*** **Resolution 2015-33, to to $30 Million Dollars in PineBridge Structured Capital**

Fund III, L.P., a Small and Middle Market Mezzanine Debt and Equity Securities Fund. The Board *unanimously adopted* the *resolution.*

4. **Recommendation to Commit up to $30 Million Dollars in Thoma Bravo Discover, L.P., a Buyout Fund Focused on U.S. Investments with a Specialization in Software Companies.** Based in Chicago and San Francisco, Thoma Bravo is a very experienced manager that acquires software companies in the U.S. ATRS invested in Thomas Bravo XI in 2014 and the fund is currently on track to perform very well. The general partner typically pursues a buy and build strategy seeking companies that operate in the application, infrastructure and security software industries. Whereas their previous funds have focused on deals of various sizes, this fund will invest in opportunities in the lower middle market, targeting investments of up to $150 million. The principals of the firm have worked together for an average of thirteen years and, on average, have eighteen years of private equity experience.

   The net returns for the manager's funds raised prior to 2014 are approximately 38% IRR. Returns for their 2014 and 2015 funds are not yet meaningful, but the funds are performing well at this time. This fund will provide additional exposure to the software industry for ATRS. Both Franklin Park and ATRS staff recommend an investment in Thoma Bravo Discover, L.P. with a commitment of up to $30 million dollars. Although the fund recommendation requested is "up to $30 million dollars", it is expected that the fund will have less than that amount available for ATRS.

   a. **Resolution 2015-34**

   Ms. Nichols *moved* to *adopt* Resolution 2015-34 to Commit up to $30 Million Dollars in Thoma Bravo Discover, L.P., a Buyout Fund Focused on U.S. Investments with a Specialization in Software Companies. The Board *unanimously adopted* the *resolution.*

5. **Recommendation to Commit up to $25 Million Dollars in Franklin Park Venture Fund Series 2016, L. P., a Fund of Funds Managed by Franklin Park Investing in Venture Capital Private Equity Funds.** This is the traditional annual

Franklin Park Venture Fund. As a reminder, Franklin Park acts as the manager of a fund of funds in the venture space, since venture is a very volatile segment of private equity. In order to offset some of that risk, Franklin Park acquires an interest in several venture funds and spreads those through its investors to create greater diversity of managers and styles. Franklin Park does not charge a fee on the investment and only recovers its legal and accounting costs for ensuring the fund is set up properly and has appropriate accounting and auditing performed. This is a big win for Franklin Park's clients due to the availability of a fund of funds without the fee on fee cost that a fund of funds typically requires. ATRS staff and Franklin Park recommend ATRS commit approximately nine percent of the pacing amount, or up to $25 million dollars, to the 2016 Franklin Park Venture Fund.

a. Resolution 2015-35

Ms. Nichols *moved* to *adopt* Resolution 2015-35 to Commit up to $25 Million Dollars in Franklin Park Venture Fund Series 2016, L. P., a Fund of Funds Managed by Franklin Park Investing in Venture Capital Private Equity Funds. The Board *unanimously adopted* the *resolution.*

6. **Recommendation to Commit up to $25 Million Dollars in Franklin Park International Fund 2016, L. P., a Fund of Funds Managed by Franklin Park Investing in International Private Equity Funds.** The International Fund has essentially the same model as the venture fund, except it is a vehicle for ATRS to get exposure to international private equity. Franklin Park created a fund of funds vehicle to invest in several private equity funds that invest internationally. The fund of funds is used to diversify and reduce risk for ATRS and the other clients of Franklin Park. Franklin Park charges no fee and only recovers the cost for legal and accounting fees required to properly operate the fund. This provides ATRS with diverse international private equity opportunities that otherwise would be difficult to obtain. Again, ATRS staff and Franklin Park recommend an ATRS commitment to the Franklin Park International Fund of up to $25 million dollars for 2016.

a. Resolution 2015-36

Ms. Nichols *moved* to *adopt* Resolution 2015-36 to Commit up to $25 Million Dollars in Franklin Park International Fund 2016, L. P., a Fund of Funds Managed by Franklin Park Investing in International Private Equity Funds. The Board *unanimously adopted* the *resolution.*

7. **Recommendation to Commit up to $65 Million Dollars in ATRS/FP Private Equity Fund, L. P., a Co-Investment and Next Generation Manager Fund Focused on Co-Investments and Smaller Funds Managed by Highly Skilled Teams With Imminent Need.** A co-investment occurs when ATRS invests directly in a private company alongside a private equity manager. The benefit of private equity co-investment for ATRS is that Franklin Park as the fund manager does not charge management fees or any incentive fees that are also called "carried interest" or "carry". Therefore, the potential for return on co-investments is much greater since no fees are netted from the investment. The "Next Generation" managers also provide excellent investment opportunity. A large number of private equity opportunities arise from smaller funds run by managers who are raising their first institutional fund. Additionally, some funds have never included public pension plans and this fund vehicle is better suited to encourage a fund to first allow public pension fund commitments. The funds are often concerned that competitors will use the public fund's reports to harm the manager's reputation in the early stages of a fund that is still in the J curve's negative return profile. Often, these funds are formed by skilled and experienced teams that have spun out of large, prosperous firms and have the attributes to be successful on their own and were successful in the original firm. Sometimes they are teams that have successfully invested their own money or that of high net worth individuals and are now capable of investing on a larger scale. The returns produced by some of these "next generation managers" in their first or their early funds are exceptional. The ATRS/FP Private Equity Fund is a fund that seeks investment opportunities from both co-investments and smaller funds managed by highly skilled teams.

   Franklin Park will target to invest $25 million dollars in approximately five to seven co-investment deals and $40 million dollars in one or more next-generation manager funds. As with the venture and international funds, Franklin Park does not charge a fee on the ATRS/FP Private Equity Fund and only recovers its legal costs and accounting costs for ensuring the fund is set up properly and has appropriate accounting and auditing performed. Both Franklin Park and ATRS staff recommend an investment of up to $65 million dollars in ATRS/FP Private Equity Fund, L.P.

a. Resolution 2015-37

Ms. Nichols *moved* to *adopt* Resolution 2015-37 Commit up to $65 Million Dollars in ATRS/FP Private Equity Fund, L. P., a Co-Investment and Next Generation Manager Fund Focused on Co-Investments and Smaller Funds Managed by Highly Skilled Teams With Imminent Need. The Board *unanimously adopted* the *resolution.*

8. **Information On CI Capital Partners III, L.P., a Buyout Fund That Will Focus on Investments in the Business Services, Healthcare Services, Government Services, Light Manufacturing and Distribution Sectors.** Based in New York, the general partner was originally formed as Caxton-Isenman Capital in affiliation with Caxton Associates, a hedge fund. The general partner began investing in 1993 and became independent in 2007. Currently, the firm is led by Frederick Isenman, Timothy Hall, Thomas Ritchie and Joost Thesseling (principals). The principals average sixteen years each with the general partner and eighteen years each in the private equity industry. In its previous fund raised in 2009, the firm generated a net IRR of 16.7%.

The general partner typically pursues a buy-and-build strategy seeking lower middle market companies in the business services, healthcare services, government services, light manufacturing and distribution sectors. Smaller companies in the fund's target sectors can often be acquired at better relative prices than larger companies. In addition to seeking attractive pricing, the firm partners with proven operating executives to acquire platforms and pursue consolidation strategies. As a result, the general partner can build scale, create operating synergies and transition its companies into larger, more efficiently run businesses. Franklin Park and ATRS staff agree that due to the tight timing to close and the fund's inexperience with public pension plans (see explanation in G above), the proper vehicle to allow ATRS to obtain an investment in this quality fund is to use the ATRS/FP Private Equity Fund, L.P.

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

1. **Performance Report for the Quarter Ended September 30, 2015.** P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting presented the performance report for the quarter ended June 30, 2015. The total market value of the ATRS fund was approximately $14.1 billion dollars. The total fund had a return of 8.3% since inception, underperforming its benchmark of 8.4%. The quarter was down approximately 5% from last quarter.

2. **Preliminary Performance Report for the Month Ended October 31, 2015.** P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting presented the preliminary portfolio update for the month ending October 31, 2015. The total market value of the ATRS fund was $14.71 billion dollars with return of 8.4% since inception, underperforming its benchmark of 8.6%. The preliminary performance for the month increased by 5% from the quarter that ended September 30, 2015.

D. Real Assets Investment Consultant Update – Aon Hewitt Investment Consulting.

1. **2016 Real Assets Commitment Pacing.** Chae Hong of Aon Hewitt Investment Consulting presented the 2016 Real Assets Commitment Pacing. For calendar year 2016, Aon Hewitt Investment Consulting is recommending approximately **$200 million dollars.**

   a. **Core Real Estate $50 Million Dollars.** Core real estate funds employ low leverage, low-risk investment strategies that have predictable cash flows. The funds will generally invest in stable, fully leased, modern, multi-tenant properties within strong, diversified metropolitan areas.

   b. **Value Added Real Estate $50 Million Dollars.** These are funds that invest in properties and make improvements to fairly stable properties but are one step below the core funds in quality. These have slightly more risk but have a better return opportunity.

c. **Opportunistic Real Estate $50 Million Dollars.** These are funds that seek to take advantage of distressed opportunities and are higher in the risk profile but with strong managers, Opportunistic Real Estate provides the best return opportunity in real estate.

d. **Infrastructure $50 Million Dollars.** Infrastructure funds invest in the fundamental facilities and systems serving a country, city, or area including the services and facilities necessary for its economy to function. Infrastructure funds typically invest in structures such as roads, bridges, tunnels, water systems, sewers systems, electric grids, ports and so forth.

Ms. Nichols *moved* to *approve* the 2016 Real Assets Commitment Pacing. The Board *unanimously approved* the *motion*.

2. **Recommendation to Commit up to $20 Million Dollars in Metropolitan Real Estate Partners Secondaries & Co-Investments Fund L.P., a Real Estate Fund in which ATRS Will Only Invest in the Co-Investment Segment.** Metropolitan Real Estate Partners (MREP) Secondary & Co-Investments Fund (the “Fund” or “SCIF”) investment strategy will be to take advantage of MREP’s primary fund-of-funds platform to source secondary investments and co-investments from existing general partner relationships. The Fund will seek to take advantage of current capital market imbalances and provide investors with access to both secondary (institutional investors and co-investment opportunities. Secondary and co-investments reduce the J-curve effect by putting money to work quicker. The Fund will be split 50/50 between secondary and co-investments segment targeting a net IRR of 15%. ATRS will be investing in the co-investment segment only, as ATRS already has exposure to the secondary market through ATRS's investment in Landmark Securities. A co-investment occurs when ATRS invests directly in a real estate investment alongside a real estate manager. ATRS began investing in private equity co-investments in 2011 through the ATRS/FP Private Equity Fund,

L. P. If approved, this fund would offer similar co-investment opportunities in real estate.

The MREP team has been together since 2002 posting average net returns of 15% in the co-investment strategy. The MREP team is headed by portfolio manager David Sherman and owned since 2013 by the Carlyle Group. The Carlyle Group was founded in 1987 and is a leading global alternative investment manager with nearly $200 billion dollars in assets under management across 120 active funds and 133 fund-of-funds vehicles.

a. Resolution 2015-38

Ms. Nichols *moved* to *adopt* Resolution 2015-38, to Commit up to $20 Million Dollars in Metropolitan Real Estate Partners Secondaries & Co-Investments Fund L.P., a Real Estate Fund in which ATRS Will Only Invest in the Co-Investment Segment. The Board *unanimously adopted the resolution.*

XIII. Operations Committee Report. Bobby Lester, Chair gave a report on the Operations Committee meeting.

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

1. General Open Forum. None.

B. **Potential 2017 Legislation.**

1. Disability Retirement to Include Reciprocal Service for Vesting. One of the ways that ATRS used to recover ground during the market down-turn was to consider any legislation that would save money and get ATRS back to a solid footing. ATRS became focused on saving money and at the same time maintaining the **3 R's** of ATRS to: Recruit, Retain, Reward career educators.

ATRS made a change in the disability law change through Act 493 of 2013. The act removed reciprocal service credit from the vesting requirement to qualify for disability benefits. *"An active* *member in employer service with five (5) or more years of actual ~~and reciprocal~~ service who becomes totally and permanently ………may be retired by the Board of Trustees of the Arkansas Teacher Retirement System……."* The actuarial cost study projected that the passage of the bill would not impact the funding position of ATRS or the amortization period, but would have a small, positive, financial impact.

While this was ***not*** a change that caused negative feedback from the General Assembly or others, it has been seen as a draw back when recruiting employees that have reciprocal service credit. Arkansas Public Employees Retirement System is a good example. Although APERS may not provide disability benefits to a member unless Social Security disability determination has occurred, they would most likely use the ATRS final average salary to base disability benefits upon when eligibility does occur. And, in most situations, the member's last employer yields the highest final average salary. ATRS sees this as a recruiting tool for employees who wish to change employers within the state and have portable benefits at the same time. Plus, until the member has 5 years of ATRS service, the member may receive an APERS disability benefit but no ATRS benefit. This inadvertently undermines the recruitment provision of the 3R's of ATRS. Remember that ATRS would only pay the benefit that the standard retirement formula generates. A member with less than 5 years of service will have a relatively small benefit anyway.

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Mr. Lester *moved* to *approve* draft Legislation on Disability Retirement to Include Reciprocal Service for Vesting. The Board *unanimously* approved the *motion.*

2. **Survivor Benefits to Include Reciprocal Service Credit for Vesting, with a Prorated Surviving Child Benefit.** For the same reasons listed above, reciprocal service credit was removed from the vesting requirement to qualify a member's family for survivor benefits. This legislative change, Act 571 of 2013, was easier to recommend, because the survivor benefits for minor children were out of proportion to the member's connection to the system. Before the change, a member with 5 years of APERS time and 0.25 years of ATRS time was eligible for the full survivor benefit.

For example: if a member with 4.75 years of reciprocal service credit joined ATRS, worked one-fourth year (.25), and died as an active member, a surviving dependent child of the member would have received an annuity equal to 20% of the member's highest one-year salary year, up to 3 surviving dependent children, or a prorata share of 60% of the member's best one-year salary. If the member's highest salary year occurs in the year of the member's death, ATRS calculates the child's annuity on the basis of a full year of salary by the member. In this example, if a member is under contract to receive $60,000, but dies one-fourth way into the contract, each surviving child would have received $12,000 until age 18 (age 23 if the child remains in school). ATRS felt the member connection to the system was too short to obligate the ATRS liabilities that each child would accrue.

Another example in conjunction with the example above: if an active member of ATRS dies in active service, has 20 years of ATRS service credit, two surviving dependent children, and a best one-year salary of $40,000, that member's dependent surviving children would receive $8,000 per year. This was the disproportionate view of the survivor law, and the reasoning for the recommended change in 2013.

If the law were to be changed back to allowing reciprocal service credit to count for vesting requirement to qualify for survivor benefits, there is a method to make the surviving child interest more proportionate to the deceased member's investment in the system. A proration of the surviving child benefit, 1% of the member's best one-year salary for each quarter of year credited with ATRS, up to 20% of the member's best one-year salary, might be the solution the Operations Committee would consider recommending to the Board. The chart would be as follows:

Quarters of ATRS Service Credit Earned	Percentage of Best One-Year Salary	Example: Best One-Year Salary $40,000
0.25	1%	$400
0.50	2%	$800
0.75	3%	$1,200
1.00	4%	$1,600

1.25	5%	$2,000
1.50	6%	$2,400
1.75	7%	$2,800
2.00	8%	$3,200
2.25	9%	$3,600
2.50	10%	$4,000
2.75	11%	$4,400
3.00	12%	$4,800
3.25	13%	$5,200
3.50	14%	$5,600
3.75	15%	$6,000
4.00	16%	$6,400
4.25	17%	$6,800
4.50	18%	$7,200
4.75	19%	$7,600
5.00	20%	$8,000

Using the chart above, a member with one-fourth year of service credit and a best one-year salary of $40,000 would be entitled to a surviving child benefit of $400 per year, and a member with five years of service credit and a best one-year salary of $40,000 would be entitled to a surviving child benefit of $8,000 per year. ATRS staff believes that proration of the surviving child benefit would make the law more equitable for all members, and would restore confidence in the members that the ATRS Board gives fair and equitable benefits. ATRS staff recommended for 2017 law changes that reciprocal service credit be included for service or benefit vesting purposes, with a prorated surviving child benefit.

Mr. Lester *moved* to approve draft Legislation on Survivor Benefits to Include Reciprocal Service Credit for Vesting, with a Prorated Surviving Child Benefit. The Board *unanimously* approved the *motion.*

3. **Pension Advance Companies**. A growing concern in other states and now in Arkansas is companies that provide retirees an advance sum of money based upon future monthly retirement payments. The interest rate on these "advances" can exceed 100%. Most often targeted groups are elderly and low income retirees. A real life example has reached ATRS: a pension advance company agreed to lend an ATRS retiree

$1,900. The $1,900 was to be reduced by $300 for a "set up" fee, netting a payment of $1,600 to the retiree. The member was to repay this advance by paying $242 a month for 60 months. A payment of $242 per month for 60 months is $14,520 to pay an advance of $1,600. Plus, ATRS would send the member a 1099 for taxes for the full $14,520 as if it were paid each year for five years. The repayment is over 900% of the net amount to be received by the member. This amounts to 152% annual interest on the $1,900. This is a real life story of one of our members.

The State of Missouri was the first state to outlaw pension advances companies. ATRS staff researched and the Board considered this issue for potential legislation in 2015. The Board felt the state laws were sound enough to prevail against this practice. Clearly, one group has made headway into Arkansas. ATRS staff recommended to the Operations Committee that prohibition of public pension advances be included in the 2017 law changes. The legislation could be limited to ATRS only or to all public pension benefits in Arkansas.

> **Mr. Lester *moved* to *approve* draft Legislation on Pension Advance Companies. Mr. Black *seconded* the *motion*, and the Committee *unanimously* approved the *motion.***

4. **Disability Retirement.** In the last Operations Committee meeting on October 5, 2015, a potential law change was presented to the Committee for modification of the method for determining disability status if Social Security denies disability retirement under its determination. The discussion of the law change centered on the process a disability retiree would follow to challenge denial of ATRS disability retirement if he or she failed to receive a disability determination letter from Social Security. ATRS executive staff wanted to ensure that the second and important part of the proposed bill was explained and discussed in this Committee.

   The current law provides a strong disincentive to try to return to work after disability retirement is obtained from ATRS. Currently, the law requires a member who returns to employment for an ATRS covered employer to immediately become active, and disability retirement benefit cease. If a disability retiree tries to reenter the workforce and fails, then the disability process must begin all over again. Disability benefits are computed without cost of living adjustments that had accrued prior to the member's reentry into active service. So if a current retiree tries to return to work and cannot make it, the law strips all COLAs and makes the member reapply for benefits.

Under the proposed legislation, a disability retiree who reenters covered employment and then returns to disability retirement may return to the higher of a recomputed benefit (based on a higher final average salary or increased service credit) or the last disability retirement benefit received. ATRS staff feels this is an encouragement to disability retirees to try reentering the educational workforce without the penalty of losing cost of living adjustments. Since this feature of the proposed legislation was not discussed at the last meeting, ATRS staff presents this potential legislation to the Operations Committee for its consideration of potential legislation to address this issue.

Mr. Lester *moved* to *approve* draft of Legislation on Disability Retirement. The Board *unanimously* approved the *motion.*

C. **Call Center Customer Satisfaction Survey**. Mr. Michael Ray along with Mr. Willie Kincade discussed the ATRS Call Center. The Call Center has been in existence since 2010. Mr. Kincade has been the Manager of the section since its inception. Mr. Kincade had an extensive background in Call Centers when he came to ATRS in 2009, and has been applying that experience since he was hired. Mr. Kincade's department not only keeps logs of the current calls, but compares logs against the previous year to gage the volume expected during any given month. As a part of Mr. Kincade's management style, he has developed a Call Center Customer Satisfaction Survey to ascertain strengths as well as any area that needs improvement. The survey will be sent to a sampling of members served by the Call Center, and can be returned anonymously, or a name can be provided with a telephone number if the member would like to speak to Mr. Kincade or any other ATRS Manager.

D. **Data Security/Preview of On-line Retiree 1099Rs for 2015.** A demonstration was conducted by Clint Rhoden and Mike Lauro to show how the new feature on the member's account via internet access will work.

With the recent news articles on computer "hacking", unauthorized release of personal financial data, and credit card fraud by leading department stores, ATRS wanted the Operations Committee, Board of Trustees, and importantly, our members to know that this is a situation we take very seriously. Not only does the ATRS Data Processing staff study this issue on an on-going basis, the Legislative IT Auditors complete a comprehensive screening of security measures each year that it audits. The last audit year by Legislative Audit IT auditors was in April 2015. There were no written findings upon exit. One of their suggestions was to complete full disaster recovery at a remote location each year, as opposed to a "desktop" test which is completed in-house. ATRS staff subsequently tested a full disaster recovery remotely in June 2015, including staff members and Legislative auditors. The test was successful, and led to updated documentation of the test. This item was placed on the Operations Committee agenda to assure all involved that this data security is one of the highest priority items in the agency, and will be kept updated going forward.

This coming January 2016, when 1099R's are produced for retirees and any members who received termination refunds, ATRS will make the 1099R form available on-line as part of its ongoing mission to serve members. Members must first be signed on to the ATRS website portal to access personal ATRS information. Once inside the "My Account" section, a tab on the left hand side of the screen will read "Member Portal". Once members click on that tab, a new menu will open up with a tab for "1099R" information. Members who are currently enrolled will not have to reenroll to access the new form.

XIV. Staff Reports.

A. Medical Committee Reports. Michael Ray presented the Medical Committee reports. A total of thirty-four (34) disability applications were received, thirty-three (33) were approved for disability benefits, and one (1) needed more information.

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

B. Financial Reports.

1. **Financial Statement Report**. The ATRS Chief Financial Officer presented the Board summary information for the financial reports for the year ending June 30, 2015. Plan net assets were $15.03 billion dollars in fiscal year 2015.

2. **Travel Report.** The ATRS Chief Financial Officer presented a standard travel report showing the expenses for staff and Trustees for fiscal year ending June 30, 2015. Board travel expenses increased slightly in 2015 as compared to fiscal year 2014. Other staff travel decreased slightly in fiscal year 2015 as compared to fiscal year 2014.

C. Contract Review. The ATRS Assoc. Director of Operations handles coordinating the ATRS' contracts with the Office of State Purchasing (OSP). The ATRS Board reviews the agency's contracts up for renewal annually as a part of the ATRS contract process. This process provides an opportunity for the Trustees to ask questions about any of the contracts on the list, approve or reject any contract being reviewed as a whole, approve or reject them individually, or ask for more information as needed. Once reviewed by the Board, staff prepares annual contracts and sends the contracts to the vendors for completion. Once the contracts are returned, the contracts are sent to the Arkansas Legislative Council for a legislative review. Most major ATRS contracts were approved for a two year period last year so only 4 contracts are up for review at this time.

D. Personnel Report. The personnel report was presented to the Board. For the second year of the current biennium (July 1, 2015 through June 30, 2016), ATRS currently has 101 appropriated positions with 98 budgeted. Currently, 18 are vacant, and 11 are advertised.

XV. Executive Session to Discuss Executive Director's Performance Evaluation. Mr. Stubblefield, Chair, called the Executive Session of the Board of Trustees to order at 2:25 p.m. Mr. Stubblefield, Chair, reconvened the Board of Trustees meeting at 2:34 p.m.

The Board expressed their satisfaction with Mr. Hopkins and praised him for his hard work and dedication to ATRS and its members.

Mr. Knight *moved* to *approve* Mr. Hopkins' current employment arrangement and provide the maximum salary as allowed by law. Dr. Abernathy *seconded* the *motion*, and the Board *unanimously approved the motion.*

XV. Other Business: None

XVII. Adjourn.

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

Meeting adjourned at 2:36 p.m.

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George Hopkins,
Executive Director

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Mr. Jeff Stubblefield, Chair
Board of Trustees

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Tammy Porter,
Recorder

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Date Approved