MINUTES OF THE REGULAR MEETING OF THE BOARD OF TRUSTEES
ARKANSAS STATE POLICE RETIREMENT SYSTEM
AUGUST 19, 2010

The regular meeting of the Board of Trustees of the Arkansas State Police Retirement System was held on Thursday, August 19, 2010 at 10:00 a.m. in the Arkansas State Police Commission Room at the State Police Headquarters, #1 State Police Plaza Drive, Little Rock, Arkansas. Vice Chair Kirk Bradshaw presided.

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

BOARD MEMBERS PRESENT:
Mr. Kirk Bradshaw, *Vice Chair, Citizen at Large*
Sergeant Brant Tosh, *ASP Tier II*
Corporal Blake Wilson, *ASP Tier I*
Mr. Donnie Underwood, *Citizen at Large*
Mr. Joe Miles, *Citizen at Large*
Dr. John Shelnutt, *Designee for Mr. Richard Weiss, Director Dept. of Finance & Administration*

BOARD MEMBERS ABSENT:
Mr. John W. Allison, *Chair, State Police Commissioner*

VISITORS PRESENT:
Mr. Mita Drazilov, Gabriel Roeder Smith
Lt. Col. Tim K'Nuckles, ASP
Major Kathy Sparks, ASP
Lt. Stan Witt, ASP
Capt. Myron Hall, ASP
Ms. Janet Chappell, ASP
Capt. Gloria Cook, ASP
Ms. Erika Gee, Attorney General's Office
Ms. Janelle Evyan, Bureau of Legislative Research
Ms. Traci Boyd, Bureau of Legislative Audit
Mr. Jody Carreiro, Osborn, Carreiro & Associates, Inc.

STAFF:
Ms. Gail H. Stone, Executive Secretary, Arkansas State Police Retirement System
Ms. Michele Williams, Deputy Director, APERS
Ms. Susan Bowers, Associate Director of Investments, APERS
Mr. Carlos Borromeo, Chief Investment Officer, APERS
Mr. Jay Wills, Attorney Specialist, APERS
Mr. Bill Dull, Chief Fiscal Officer, APERS
Ms. Linda McGrath, Administrative Specialist, APERS

NEWS MEDIA NOTIFIED:
A letter of notification of the Arkansas State Police 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.

RECOGNITION OF NEW BOARD MEMBER:
Mr. Bradshaw introduced the newest Trustee: Mr. Joe Miles. Mr. Miles stated that he was the president of First National Bank and Trust Co. of **Mountain Home. He said he appreciated the Governor appointing him and he hoped to do a good job for the State Police.**

MINUTES:
A copy of the Minutes from the May 20, 2010 meeting of the ASPRS Board of Trustees was mailed to each member for review prior to the meeting. Sgt. Tosh motioned for the May Minutes to be approved; he was seconded by Cpl. Wilson. The motion was unanimous.

ELECTION OF NEW BOARD CHAIR:

Ms. Stone explained that this was a technicality since Mr. Allison's term expired July 1, 2010. He had since been reappointed by the Governor, however the Board needed to formally elect a new Chair. Mr. Bradshaw suggested the Trustees table the discussion until the next meeting when Mr. Allison would be in attendance and the rest of the Board agreed to do so.

SUMMARY OF RETIREES:

June 1, 2010 – Ella Anthony, Beneficiary of Perry Anthony, Jr.
Gaye Williams, Beneficiary of Johnny Williams
Roger McLemore, Retiring from DROP
Norman Nowlin, Retiring from DROP

July 1, 2010 – John Bishop, Retiring from DROP
Andrew Harris, Jr., Retiring from DROP
Donald Sanders, Retiring from DROP
Andrew Wiley, Retiring from DROP
Anthony Baughman, Retiring from DROP
John Catlett, Retiring from DROP

Aug. 1, 2010 – Charles Westerman, Retiring from DROP
Charles Carter, Retiring from DROP
Elizabeth Davidson, Beneficiary of Billy Davidson
Charles Beall, Retiring from DROP

After a brief review, Cpl. Wilson motioned to accept the summary of retirees. He was seconded by Mr. Underwood and the motion carried unanimously.

REQUEST FOR DROP PARTICIPATION:

July 1, 2010 – Mickey E. Simmons

On a motion by Cpl. Wilson and a second by Sgt. Tosh, the DROP application was approved.

PRELIMINARY ACTUARIAL EVALUATION – Presented by Mr. Mita Drazilov from Gabriel, Roeder, Smith and Company

Mr. Drazilov reminded the Trustees that the purpose of the annual valuation was to determine employer contribution rate for the next Fiscal Year, as well as assess the health of the financial system at of the close of the last Fiscal Year. He gave an overview of the participant and financial data that had been collected from the years 2000-2010. He pointed out that the "average pay" had increased roughly 5% during the last Fiscal Year, but he attributed that to the unusual 27 pay periods, one more than usual, experienced during that time period, rather than a spike in salaries.

As of June 30, 2010 the system had 543 active members and 554 retired members (which includes the 85 currently in the DROP). Payouts to retirees and their beneficiaries accounted for $15.7 million (or 55% of pay) annually - larger than the employer contribution. Mr. Drazilov stated that this is not necessarily a bad thing, since this is a pre-funded plan, but it means that the fund is highly reliant on its investments to make up the difference.

He walked the Trustees through the Development of the Funding Value of Assets and explained how the 4-year "smoothing" helped level the volatility in the system and keep a relatively stable Employer Contribution Rate. Mr. Drazilov detailed the difference between Market Value and Funding Value and reminded the Board of the additional $9 million ASPRS was given at the beginning of Fiscal Year 2010.

The normal cost of one year of service in ASPRS is 20.28% of pay, however when the Unfunded Actuarial Accrued Liabilities are factored in (an additional 24.62%), the projected Employer Rate comes in at 44.90% of pay. This is a slight increase, 0.2%, over last year. These are projected numbers and the official report will be given to the Board during the November meeting.

Mr. Drazilov showed the Board projected Valuation Results for three different market return scenarios, ranging from pessimistic through optimistic. The Employer Rates ranged from the current 44.90% with the System being 62% funded to a possible Employer Rate of 51.39% in 2013 with the System being 52% funded. This diagrammed how dependent the Employer Rate was on the Investment Returns. Under all the scenarios the Funded Ratio was expected to decline as the losses from 2008 and 2009 were phased in. Mr. Drazilov emphasized that it would take a long time to get the Funded Ratio back near 100% and this was dependent on two key drivers: positive investment returns and receiving the required employer contributions as determined by the actuarial valuations.

Mr. Miles asked what sort of market returns would be required to raise the funded ratio based on the three scenarios Mr. Drazilov displayed. Mr. Drazilov said he would need to go back and crunch the numbers to answer exactly, but he opined that it would take a number of years of double-digit market returns to get the system back near the 100% Funded Ratio.

Overview of GASB "Preliminary Views" on Pension Fund Valuation
Mr. Drazilov gave a brief overview of the effects of the newly proposed GASB (Governmental Accounting Standards Board) rules of how employers should do the financial reporting of their defined benefit plans. The fundamental changes will affect the balance sheet with respect to the Unfunded Actuarial Valuation. In many instances, retirement systems will be required to show what GASB called the "Net Pension Liability" which is higher than the Unfunded Actual Accrued Liability currently displayed in the report. In addition, the pension expense will become much more volatile as the allowable amortization period will be drastically shortened from the currently allowed 30 years, to somewhere in the range of 8-15 years. Also any vested gains/losses that exceed the 15% corridor will need to be immediately recognized.

GASB is looking for public comments through mid-September and will be holding three public hearings across the country in October 2010. Mr. Drazilov commented that they seemed to be "fast-tracking" these substantial changes to the balance sheets of employers who sponsor defined benefit plans. Ms. Stone added that what it meant to ASPRS is the annual financial report will show a larger and more volatile number assigned to this plan. She noted that almost every state retirement system in the country was up in arms regarding this proposal, but admitted that GASB has not been very receptive to public comments in the past.

Mr. Bradshaw inquired what the funded ratio of the plan had been prior to the market collapse in 2009. Ms. Stone stated that one needed to look back in the history of the ASPRS to see where the plan had gotten into trouble. She pointed out that the troubles began around 1993 when certain benefits were enacted but never paid for. The next blow to the system came in 2001-2002, when under a different financial advisor, the plan was fully invested in risky growth products just as the tech bubble burst, forcing the plan to recognize huge losses and bringing the funded status down to 71% in 2005. The Trustees quickly replaced the financial consultant with Callan Associates, who managed to bring the plan up to 76% before this latest market crisis. Mr. Drazilov commented that normally the actuaries prefer to see a plan fall in the 70-80% funded ratio, however a 70% funded plan moving upwards was preferable to an 80% plan in a downward spiral.

QUARTERLY REPORT FOR THE PERIOD ENDING June 30, 2010 – Presented by Ms. Gail Stone, ASPRS Executive Secretary
Ms. Stone reminded the Board that the ASPRS fund had been merged with APERS in accordance with Act 1242 of 2009. She explained that the Actual Asset Allocation is fairly close to the Target Asset Allocation with a slight underweight (3.5%) in the Alternatives portfolio, due to the illiquid nature of that class and it takes time to get money invested in that area.

The ASPRS allocation percentage of the APERS fund grew from 3.72% to 3.82% with the addition of the $5.2 million insurance premium monies. While the fund lost money during the last quarter, it showed investment gains of 11.95% for Fiscal Year 2010.

Ms. Stone drew the Trustees attention to difference in the reported investment gains; 11.95% from Callan while GRS listed it as 14.3% return in the Actuarial Report. She explained that the difference was as a result of an accounting gain when transferring the ASPRS funds into APERS investment program.
Mr. Bradshaw went back to the three market return scenarios projected by Mr. Drazilov and asked what would happen if the system experienced one or more years of negative returns as they did last year. Mr. Drazilov reminded the Board that the target was 8%, so in effect a year of 0% returns was actually -8% to the system, and a 5% loss was actually a 13% loss because of the leveraged aspect. If the investment income failed to make the 8% Actuarial Assumption, the difference had to be made up from other sources, namely Employer and/or Employee contributions (or reconsideration of benefits).

Dr. Shelnutt inquired about the Insurance Premium Tax that provided a large chunk of supplemental income to the system and Mr. Carreiro explained that there was not a straight-forward answer. Currently, the Premium Tax comes in from several sources and a formula that distributes to Local Fire and Police funds with the rest going to General Revenue; out of the General Revenue monies, several other areas are earmarked, one being the "back-fill" on the contributions for the State Police Retirement System. This amount has ranged from zero to five million (last year).

Mr. Carreiro stated there were several problems with this method of funding, one being more of a perception problem in that LOPFI considered it all "their money" while it was clearly marked for "General Revenue". Regardless, there was more and more pressure being put on these funds and as the ASPRS Contribution Rate increased, there would come a time when these funds would be insufficient to cover all the demands and a decision would have to be made as to who comes first.

From an actuarial standpoint, Mr. Carreiro explained, dependence on the "back-filling of the contribution rate" is not sound practice. The 2009 calculated rate of 44.7% assumed that amount would be contributed evenly into the plan through-out the year, not as a large injection at the end. This dilutes the effectiveness of the money. There was also the problem of negative cash flow and the difficulties of being fully invested when such a large chuck came at the very end of the fiscal year; however he admitted that this was not as much of an issue now that the money was merged with the much larger APERS fund.

Currently, LOPFI was looking for a "more fair formula" for the distribution of the Insurance Premium Tax, which would allow them to capture more of the funds before turning the rest over to General Revenue. Mr. Carreiro stated he would be presenting some suggestions to the Pension Review Board and LOPFI over September 1 & 2, and eventually he would be called before the Governor to make a presentation. He planned to discuss using a different source of state money that could be tapped throughout the year for State Police, which would be more effective at funding the system. He theorized that if it was all "state money" perhaps the budget could be rearranged in such a fashion, as to eliminate the grumbling. Both Mr. Carreiro and Mr. Drazilov admitted LOPFI was facing many of the same pressures and problems as ASPRS.

Mr. Carreiro cautioned that what had occurred in 2008 had pushed the employer contribution rate almost to 50% for ASPRS with no immediate signs of backing down (short of 5 years of 20% investment returns). Under normal markets, he would not expect to see the rate decline for at least 20-30 years. Ms. Stone added that she understood there would be no new troopers hired for the next 2-3 years; this would exacerbate the problems in the plan that already had too few new entrants and a growing number of retirees. She stated that she, Commissioner Allison and George Hopkins had been tasked with bringing funding ideas forward in advance of the Legislative session.

FINANCIAL STATEMENTS FOR THE QUARTER ENDING JUNE 30, 2010:
This report was acknowledged without comments.

OTHER BUSINESS:

Litigation Update – Mr. Jay Wills, APERS Attorney Specialist
In the McLemore case, Mr. Wills explained that Staff was in the process of collecting and furnishing a list of potential class members to the plaintiff. The plaintiff has the financial burden of notifying the members of the class and giving them the opportunity to opt in or out. Mr. Wills stated that he still felt this would never get to trial, but instead be decided on cross-motions for summary judgment, purely a question of law. He opined that the judge would be quick to establish a briefing schedule, now that the class had been certified.

Attorney General's Opinion Request – Mr. Jay Wills, APERS Attorney Specialist
Earlier this spring, Staff requested an Attorney General's Opinion concerning ASPRS members who had entered the DROP prior to July 1, 2007 were entitled to have the market rate of return applied to their DROP earnings, despite the Legislature giving the Board authority to set a lower rate. Mr. Wills gave a brief history of the DROP interest rates prior to July 1, 2007 and explained the purpose of the request for the AG's Opinion for the newer Board members. He stated had researched all the previous Opinion's addressing a reduction in benefits that he could find and fully expected the AG would uphold the constitutionally protected of property interest in retaining the higher rate of return, despite the change in legislation.

Yesterday (August 18, 2010), an Opinion had been released stating that the Attorney General could not give a definitive answer. He suspected that had to do with the evolution nationwide of pension funds in financial difficulties to the point that some are attempting to reduce benefits of their members in an effort to remain solvent. On the final page it was opined that the Court will have to come to a definitive answer on this since there are so many factors in play and could not concretely define the DROP interest rate as a constitutionally protected property interest, but more of a procedural change on how a fund maintains its solvency.

Mr. Wills urged the Board to get a number of people that this affected and the financial impact on the fund, either way. He stated that he'd heard the number to be between 30-40 individuals, but didn't know how many would press the issue to the point of litigation. Mr. Wills pointed out that there was possible alternative: a provision for a Declaratory Judgment Action that could be filed on the interpretation of the statute that might ease any hard feelings against ASPRS. He planned to go back and review that statute, but strongly suggested the Board needed hard numbers before proceeding in any direction.

Corp. Wilson motioned for Staff for calculate the number of members impacted and costs associated with this decision. He also requested that Staff work on possible interest rates for the next few years and the amount of payouts associated with such interest rates. He was seconded by Mr. Underwood and the motion passed. Ms. Stone stated that she could have that information relatively quickly, so the Board could take any necessary action in a timely fashion.

DISABILITY REQUEST FROM CORPORAL DAVID CHASTAIN:
After the Board had a chance to review the doctor's statements, Cpt. Wilson motioned to approve the disability request from Cpl. David Chastain. Sgt. Tosh seconded the motion and it passed unanimously.

NEXT QUARTERLY BOARD MEETING:
The next quarterly meeting of the ASPRS Board will be held on November 18, 2010 at 10:00 a.m. Ms. Stone cautioned that there was a high probability of the Board would need to schedule a special meeting sooner to address the recent Attorney General's Opinion regarding DROP interest rates.

ADJOURNMENT:
There being no other business the meeting was adjourned.

COMMISSIONER JOHN W. ALLISON
Chair, Arkansas State Police Board of Trustees

GAIL H. STONE
Executive Secretary