

JOINT COMMITTEE ON PUBLIC RETIREMENT & SOCIAL SECURITY PROGRAMS**JANUARY 17, 2018****MINUTES**

The Joint Committee on Public Retirement and Social Security Programs met Wednesday, January 17, 2018 at 9:00 a.m. at the Association of Arkansas Counties Building, 1415 West Third Street, Little Rock, Arkansas.

Committee members present were: Senators Joyce Elliott, Jason Rapert, and Larry Teague. Representatives Douglas House, Co-Chair, Bruce Coleman, Charlene Fite, Ron McNair, Clint Penzo, Johnny Rye, and Les Warren.

Other members present were: Representatives Jon Eubanks and Roger Lynch.

Trustee Education Seminar, sponsored by the Arkansas Public Employees Retirement System (APERS)

Committee members had been invited by APERS to attend the seminar. The seminar provided members an opportunity to learn more about pension trustees' legal duties and their personal liabilities.

Call to Order

The meeting was called to order.

Investments 101 – Presentation on Important Points for Trustees to Consider When Evaluating an Institutional Investment Portfolio, such as APERS. Ryan Ball and Brianne Weymouth, Callan LLC presentations.

Ryan Ball, Senior Vice President, and Brianne Weymouth, Senior Vice President, Callan LLC, were introduced. Mr. Ball told the attendees that Callan acts as consultants for the Arkansas Public Employees Retirement (APERS) board and staff. He noted topics that he and Ms. Weymouth will discuss:

- Asset Allocation - asset allocation focuses on the big picture of the allocation of stocks, bonds, and real estate for the system. Callan prepares the following reports for the APERS board
 - An Asset Liability Study is prepared every three to five years
 - A Report on capital market expectations is prepared annually

Mr. Ball stated that the data on all asset classes in U.S. stocks, bonds and real estate in Callan's capital market expectation report is used as input in their performance forecast models. He discussed strategic policies that govern any pool of assets:

- Investment policy – how will the assets support the benefits/spending
 - Risk and return parameters are the asset classes you invest in
 - Type of restrictions, employer contributions that could impact liabilities and benefits

Mr. Ball reviewed manager structure:

- The number and types of managers within an asset class

- The development of long-term strategic asset allocation among managers that is efficient and accurately reflects the strategic investment philosophy of the portfolio
- Structure identifies and recommends allocation adjustments for unintended exposures or “gaps” in the portfolio and outlines a series of action steps to implement the structure

Ms. Weymouth reviewed factors Callan uses in a manager search. A research group consisting of thirty-four employees focused on meeting and evaluating investment managers. Investment managers are evaluated on performance and management styles:

- Passive Management- an investment manager purchases a basket of stocks cheaply
- Active Management- investment managers pick stocks and actively manage the portfolio
- Enhanced Indexing- investment managers make adjustments between passive and active management to increase returns over time

Mr. Ball discussed capital market risks and said that active management risks occur when managers make active decisions that differ from the index. Liquidity risks refers to the state of a security or other assets that cannot easily be sold or exchanged for cash without a substantial loss in value. APERS total performance is found in the Callan report.

He then reviewed a portion of APERS portfolio in fixed income securities, which he said include a number of sectors:

- Treasuries- the most conservative bonds above cash and backed by the U.S. government
- Agency Bonds- bonds issued by government agencies and backed by the U.S. government. These bonds are fairly safe with lower interest rates
- Corporate Debt- debt of companies when corporations issue debt as credit with more risks than government-backed bonds
- Mortgage Backed Securities (MBS)- occur when a sponsor buys mortgages, then pools and packages for sale to the public. These securities have the biggest risk
- Commercial Mortgage-Backed Securities (CMBS)- publicly traded bond-like products that are based on underlying pools of commercial mortgages
- Asset Backed Security (ABS)- secured by money owed to a company for merchandise or services purchased on credit. A securities firm bundles debt, such as credit card or car loans, and sells investors the right to receive the payments made on these loans

Mr. Ball described APERS total fund performance compared to other public fund systems based on differences in asset allocation. APERS' fund performance is above average in domestic equity, below average in fixed income, and above average in international equity. Overall, APERS has done better than its peer group of publicly-funded systems because equities have been leading the market and is heavier in equities than the median publicly funded systems. Current data shows that the total returns for APERS over the last five years is 9.48% annually.

Actuary 101 - Discussion of Key Actuarial Data and How to Think about the Data Provided by Actuaries

David Hoffman and Mita Drazilov, Actuaries, Gabriel Roeder Smith, were recognized. Mr. Hoffman said discussion topics will include:

- The annual evaluation report based on the evaluation of the APERS system ending June 30, 2017
 - Preliminary report provided to the APERS Board August 2017
 - The Board adopted the employer contribution rate of 15.32% for the twelve-month period beginning Fiscal Year, July 1, 2018
 - The final evaluation report was presented to the Board in November 2017

Mr. Hoffman referenced legislation that allowed APERS to establish a new employer contribution rate each year. He believes this is was very forward-thinking to address adjustments and differences in benefits and investment income over the years. The single measure most systems focus on when discussing retirement benefits is the funded ratio. The amount of unfunded accrued liability is the difference between the calculation of accrued liability and the value of assets. In retirement systems annual contributions, the contribution for service is the amount members have earned each year. The current benefit payouts are \$500 million from a \$7 billion payroll, approximately 30% of the member's salaries. In the past, the contributions far exceeded the benefit payments. The employer contributions beginning July 1, 2018 for Fiscal Year 2018 is 15.3% of payroll with an additional 3½% paid for by the members. If future payroll contribution expectations remain consistent, then 19% of member's payroll will continue to allow for benefit payouts at 3% of member's salaries.

Mr. Hoffman discussed a review of benefit provisions prepared at the request of the APERS Board for suggestions on how the unfunded accrued liability can be reduced. He said similar reviews have been done for a number of public retirement systems. What the review found is that a reduction in the Cost of Living Adjustment (COLA) provides the greatest benefit. He believes that reducing the current 3% COLA down to 2% would save the most money.

Mr. Hoffman discussed a five year experience study being prepared for the Board that will measure liabilities annually over the past five years. The study will make future actuarial assumptions and the results of these calculations will be based on these assumptions. The study will include two risk areas:

- Demographic
 - the number of eligible members who retire
 - the number of members who may become disabled and terminate employment
 - the number of members who pass away after retiring or in service

- Economic
 - Investment return
 - Inflation
 - Salary increases

Board members and legislators asked questions and discussed the challenges the APERS Board faces making decisions for the system.

There being no further business, the meeting adjourned at 2:45 p.m.