

**State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
DEFINED CONTRIBUTION PLAN COMMITTEE MEETING**

**Grand Hyatt Hotel, Sealth Room, 6th Floor
Seattle, Washington
October 31, 2007**

ATTENDANCE

Committee Present: Sam Trivette, Chair
Tom Richards
Mike Williams

Other ARMB Trustee Present: DOA Commissioner Annette Kreitzer
(attending in her capacity as Commissioner
of the Department of Administration)

Investment Advisory Council Present: Dr. William Jennings

Department of Revenue

Staff Present: Deputy Commissioner Brian Andrews, Gary Bader (chief investment officer), Zach Hanna (state investment officer), and Bree Simpson (asst state investment officer)

Department of Administration

Staff Present: Patrick Shier (director of Division of Retirement & Benefits), Kathy Lea (retirement & benefits manager, Division of Retirement & Benefits)

Others Present: Kent Morris and Perry Christie (Great-West Retirement Services/Advised Assets Group); Bob Birch, Ned Notzon, Chris Dyer and Charles Shriver (T. Rowe Price)

CALL TO ORDER

COMMITTEE CHAIR SAM TRIVETTE called the meeting to order at 8:30 a.m. on Wednesday, October 31, 2007.

ROLL CALL

All three committee members were present at roll call to form a quorum.

PUBLIC MEETING NOTICE

MS. SIMPSON confirmed that the public meeting notice requirement had been met.

APPROVAL OF AGENDA

GARY BADER asked that two items be added to the "Opportunity for Comment" section: the Division of Retirement and Benefits, and the Department of Revenue.

TOM RICHARDS moved to approve the agenda as amended. The motion passed unanimously.

APPROVAL OF MINUTES

MIKE WILLIAMS moved to adopt the minutes of the September 25, 2007 meeting. The motion carried without objection.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

Participants in the meeting who were present in the room introduced themselves, at CHAIR TRIVETTE's request. There was no one present from the public.

SUMMARY AND REVIEW

MR. BADER stated that three documents in the meeting packet were responses to Committee questions or comments at the September and August meetings: (1) a schedule of managed account fees from Great-West that represents the likely cost to the participant for the first three years of their employment - \$155.00; (2) response from Great-West, through Kathy Lea, with an estimate of how long it would take to get 50% participant response in managed accounts - three to five years; and (3) modified exhibit from T. Rowe Price on portfolio values based the 2007 salary and on the salary at the time of retirement.

MR. BADER briefly summarized what the Committee has covered so far in three previous meetings. He said that Mr. Hanna of the ARMB portfolio management staff presented analysis of the Great-West and T. Rowe Price products by normalizing assumptions in order to compare the two approaches using Monte Carlo simulations. Mr. Hanna defined success as the probability of achieving 80% of pre-retirement income adjusted for inflation. His findings were that the T. Rowe Price and Great-West asset allocations provided for about the same probability of success — and all other things being held constant, that the cost of managed accounts had a significant impact on the probability of success. The staff recommendation from Mr. Hanna was to use age-based target date funds as a default investment option in the Supplemental Benefit System (SBS) and defined contribution retirement plans. There was also desire at the Committee level to let Great-West reflect on Mr. Hanna's work and provide comment.

CHAIR TRIVETTE stated that the ARMB Defined Contribution Plan Committee has done a comprehensive job of due diligence on default options and has uncovered a lot of things it would not have otherwise. He said he appreciated the work that everybody has put into this. He mentioned the presentation by Lori Lucas of Callan Associates at the ARM Board's Education Conference earlier in the week, as well as additional

information on best practices from the board's outside legal counsel Rob Johnson.

OPPORTUNITY FOR COMMENT

1. Great-West

KENT MORRIS and PERRY CHRISTIE of Great-West/Advised Assets Group presented some additional points and explanations about Reality Investing, the managed account service that they provide to the State of Alaska SBS and defined contribution retirement plan participants. *[A copy of Great-West's presentation, dated October 2007, is on file at the ARMB office.]*

MR. MORRIS responded to points made in Mr. Hanna's staff presentation at the September 25, 2007 meeting, as follows:

- Staff had said that asset allocation differences between the Great-West managed account approach and T. Rowe Price result in a lower wealth projection. He said that the methodology used by Ibbotson, who is the fiduciary expert for Great-West, is not to try and maximize wealth but to achieve a replacement income. Great-West's glide path became much more conservative over time, and that was because the person was on track to reach their retirement objectives, which means ending up with a lower account balance. There is no need to take that amount of risk anymore.
- Staff has said that managed account fees represent a drag on projected retirement wealth of approximately \$1.8 million. Certainly, where there is an expense, there is going to be a difference. Great-West looked at an example of a 35-year-old, which is more representative of the State population. Discounting back what the expense would be in present value terms, the 11 basis points of T. Rowe Price versus 50 basis points on the Great-West managed account service, the gap would be approximately \$5,000, which is investment advice for life. So, while significant, Great-West believes there is value in what the managed account service offers.
- Staff's presentation had said that contribution rates for the Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS) plus SBS reflect satisfactory probabilities of achieving a successful retirement outcome. Great-West agrees that for the 25-year-old group it does not matter whether they are in a balanced fund, an age-based fund, or a managed account: they were going to reach their goal with 40 years of contributions. However, a distribution of age-based outcomes would challenge the conclusion, regardless of whether other life factors were presented. MR. MORRIS said he would take the Committee through some other scenarios where there is a difference, particularly when looking behind the age of 35, if there are life events that occur, or the 45- and 55-year-old really needs some additional guidance or they would not be reaching their retirement goals.

- Staff had said the Great-West model represents a lower probability of success and a lower projected wealth accumulation. Great-West's response is that the Advised Assets Group model's more conservative glide path really produced less risk for the participant and actually showed a retirement age of 59 at the 25% contribution rate or age 62 at the 15% contribution rate. That goes back to not trying to maximize the wealth accumulation but getting to the replacement income. If the goal was to maximize wealth, 100% of the money could be put in an international fund, which would project out the highest capital market expectation. That is not Great-West's approach.

MR. RICHARDS drew attention to the line on the Fee Review slide that said Social Security (TRS) Yes, and CHAIR TRIVETTE told Mr. Morris that teachers in Alaska do not pay into Social Security and do not receive Social Security benefits. MR. MORRIS said the present value of expenses shown would still be the same.

MR. MORRIS stated that managed accounts is a personalized service that looks at: (1) the savings rate (if someone is going to be short at retirement, there is an opportunity to adjust the savings rate, either in the plan or through outside assets); (2) the retirement age, realizing that participants retire at different ages; and (3) the probability of goal achievement. The value added is that with the customized personal planning a participant can go in and update data, there is an annual account statement that tells the participant if they are on track, and there is personal assistance where they can talk to a local representative or a registered investment advisor.

MR. MORRIS briefly reviewed the participant scenarios that staff had asked Great-West to prepare when this committee first began its work. He used these to illustrate than any life-changing event — such as saving for two children for college, \$10,000 a year — would substantially reduce the probability of achieving enough retirement income. The value of the managed account service is guidance to increase the savings rate, defer the retirement age, and save or invest outside the plan, etc., in order to reach the income needed at retirement.

MR. RICHARDS indicated that he was not present to hear Mr. Hanna's presentation at the September 25 meeting, but he spent some time going over the information with him later. Referring to the probabilities of success in the 70% to 74% range in Great-West's scenarios, he said that seemed a low chance that a participant would be able to live on the retirement income from the plan. He said there are studies that indicate 80% or even 90% probability of success is where people would be happier. He asked for comment.

MR. MORRIS said that Great-West uses a 70% probability of success, but that is looking at achieving replacement income that is 100% of employment income on a post-tax basis. So the higher probabilities in the 80-90% range may be looking at income

replacement that is less than what a person was earning while working. If Great-West were to plug in an 80% probability of success, the feedback would be that age 65 is not going to be the retirement age, or that savings or other outside investments would have to be increased.

MR. HANNA pointed out that his number was 80% of pre-tax income, while the Great-West number is 100% of post-tax income. So they are probably roughly equivalent. He added that 70% is used as the minimum acceptable level of success probability, and once you go below that it suggests using a higher contribution rate or delayed retirement. Lastly, he noted that on Great-West's scenario #1 Social Security does play a significant role in that probability of success; if that were taken out, he would expect the success rate would go down markedly.

MR. MORRIS stated that a 25-year-old employee has a lot of time and will likely get where they need to be at retirement. Where the differences start to play out is for the 35-year-old and older, and if there are life-changing events.

MR. CHRISTIE explained that there are three aspects of the State of Alaska plan. Great-West is the State's recordkeeper. Then there is the array of investment options, and the Board picks those. One of those investment options is whether the ARMB wants target date funds in there or not. It is not managed accounts and does not fit in that classification. The managed accounts is the third aspect, a financial service, an investment advisory service. That service is separate from the investment options and will use the investment options to tailor someone's portfolio. The service will also give them a report card consistently throughout their lifetime to help them reach their retirement goals. He said he pointed that out because things were getting misconstrued by comparing managed accounts to the target date funds. He contended that the managed account service is actually relatively cheap because of the buying power of the \$2 billion SBS plan and would cost more from an outside broker.

MR. CHRISTIE said the Committee asked Great-West to look at how many people have made contact with the managed account service and how frequently. Four percent have already updated their financial information, and 20-25% have updated other information, such as whether they have spouses or children or about their future plans. Other people may not have had a change in their financial data that would trigger them to contact the managed account service. Great-West is very positive that they will be reaching at least 50% of plan participants in three to five years. And Great-West has not gone to step two yet, which is reaching out to people.

MR. CHRISTIE stated that the managed account service will change in time. Great-West does not manage to the average participant but will be working with each particular participant, and there is a value in paying for that individual service. Great-West has not talked to the Committee about enhancing the service to address spend-

down — when a person reaches 65, will they get actual help in how to take their money out? When a retiree is 65 their life expectancy may be another 20 years, but once they reach 75 their life expectancy is longer. Those things don't get adjusted by a target date fund. But it is not that a target date fund isn't good, and he encourages the ARMB to have target date funds as part of the investment options for people to make that choice. But the average participant who needs guidance will want somebody to help them.

MR. CHRISTIE said that he is not surprised that surveys show most people using target-based funds because managed account services are fairly new. Great-West is finding that that is already changing, especially in the government sector. He briefly reviewed the value of Reality Investing (*summarized on slide 10*). Great-West has five other states that recognize how important the managed account service is, and those states won't leave their participants on their own without some kind of education and security to make sure they reach their goals.

As follow-up to the September meeting, CHAIR TRIVETTE reminded Great-West that they were going to provide information on the percentage of people in the corporate sector that are connected and involved with a managed account product, as well as information from the five state plans about participation in Great-West's Reality Investing service.

MR. CHRISTIE explained that Great-West went to all their managed accounts clients to come up with the 20-25% overall "touch rate" he mentioned earlier. He reminded the Committee that this is over a short time period, two to three years at the most.

CHAIR TRIVETTE asked on what basis Great-West stated its goal of reaching 50% of the participants in three to five years. MR. CHRISTIE said because they had such a high touch rate over one year (20%), and projecting that out. Also, Great-West is working with the Division of Retirement and Benefits, which has pretty specific goals on what they want to achieve. The first year was spent explaining to participants what happens to them in terms of retirement, but not specifically about Reality Investing. Great-West is getting ready to hold a planning meeting with the Division to review the details of reaching out to people in managed accounts. So as people see their annual report card and start getting newsletters and communications, Great-West is positive that people will update their profile even quicker than is happening with their average client.

MR. WILLIAMS said he appreciated the educational service component of Reality Investing and the value the participants are getting from this service. He inquired about the market rate for a financial advisor's services if used once a year.

MR. CHRISTIE replied that most financial advisors would not take accounts of \$3,000-\$4,000. Once assets have accumulated, it is often a percentage of assets — 1% to

1.5%, or a flat fee in the \$3,000 to \$4,000 range per year to update a financial plan. Many brokers are starting to do individual services as well, and the fees have been around 1.25% to 1.5%.

CHAIR TRIVETTE asked what Great-West meant by "touch rate," if it meant these participants were providing information about assets outside the plan, etc., or if it was simply counting any kind of contact. MR. CHRISTIE said that touch rate means that Great-West has had some update on their information but it's not always financial. He said he did not want to mislead the Committee into thinking that the contacts were all the type where a participant might call in and say they would be sending a child to college and incurring a certain expense, and so that expense would be put into the model. It could be something as simple as a participant reporting that they got married. MR. MORRIS added that 4% is the number that have provided financial information.

COMMISSIONER KREITZER inquired if a participant contacts Great-West about a changed marital status if Great-West would use that opportunity to ask if there was any other information the participant might want to share. MR. CHRISTIE stated that people will only reach out X number of times. When they are comfortable and reach out, Great-West is good at prodding for all the information they can get at the time, because they don't know when the participant will make contact again. He said that Great-West tried to get people to do these things on their own in the past, and they found that approximately 80% had no interest.

Regarding participants investing money outside their employer retirement plan, MR. RICHARDS asked when people provide that information if Great-West offers advice about that money as well, if they are in the managed account service. MR. CHRISTIE stated that right now the advice itself is only on the investments in the SBS and retirement plans, but the advice takes into consideration the outside assets.

CHAIR TRIVETTE asked if Great-West had any data from their corporate or state plan clients, or even from other sources, on how many people that they get additional information on actually raise their contribution rates as a result of working with them. MR. CHRISTIE said he did not have specific data on that but he thought they might be able to get it. He said he has heard that when people are getting their report cards the Great-West service center or the representatives get a flurry of calls about raising contributions. Great-West also hears from people who are angry about their report indicating they aren't saving enough and saying they don't have enough money. Great-West's response is that they did not know that because the person has not provided that information.

CHAIR TRIVETTE said that would be great information to have down the line.

KATHY LEA stated that one plan the Division has, once they get past the initial phase,

is to work more closely with Great-West in order to target people for Deferred Compensation Plan information.

Deputy Commissioner Brian Andrews asked to be excused at 9:18 a.m. to catch a flight.

CHAIR TRIVETTE called a brief break at this point.

2. T. Rowe Price

BOB BIRCH, NED NOTZON (lead manager on Alaska account), CHARLES SHRIVER (backup manager on Alaska account) and CHRIS DYER appeared before the Committee. *[T. Rowe Price had a short presentation, which is on file at the ARMB office.]*

MR. DYER briefly reviewed the goal to select a default investment option that is designed to allow participants to meet their long-term retirement goals. A default option is for those who make no investment election, or for those who want someone else to do the work for them. These people are generally the least engaged in the retirement planning process. Data shows that most plan sponsors, when trying to address this issue, are offering generally low-cost options for default options.

MR. NOTZON said that the Committee just heard a presentation that addressed the question of, if someone has a complicated financial life and provides a lot of information would they benefit from advice. T. Rowe Price is looking at the opposite question: what if someone provides no information and the only thing known is their age, what sort of glide path should the plan sponsor put them on - the Great-West glide path or the target date funds glide path?

MR. NOTZON presented a graph of a survey of defined contribution plans inquiring about their default investment option, done in 2004 and again in 2006. During that period there was a lot of change: revision of the Pension Protection Act (which does not apply to Alaska's plan but shows what is happening on the corporate side); and some turmoil in a number of investment sectors. In 2004, 9% of the plans selected a target risk portfolio as a default option. In 2006, 22% of the plans reported selecting a target risk portfolio as their default option, and 31% had selected a target date option. Balanced funds declined as a percentage of default options, going from 29% of the plans in 2004 to 15% in 2006. Stable value and money markets also declined from 50% of the plans to 26%. In the latest regulations from the Department of Labor, stable value is not an allowable option for automatic enrollment, except there is a grandfathering clause. Managed accounts were the default option for 7% of the plans in 2004, and that declined to 4% in 2006.

Responding to Commissioner Kreitzer, MR. NOTZON said he thought the data was largely an indication of what is happening in the private sector.

MR. NOTZON stated that low cost means that more assets are working for the participant. T. Rowe Price's management fees are 11 basis points averaged across all the State's assets. A target date portfolio with 90% of the assets in stocks would pay 13 basis points in fees. But as a person gets 30 years past retirement, only 20% of the target date portfolio is in stocks, so the management fee would be nine basis points. There is no investment management overlay fee for the ongoing asset allocation — T. Rowe Price developed all the research for the glide paths and the Monte Carlo analysis and so on, but they don't charge for it.

MR. NOTZON said the target date funds offer a very simple solution for people who don't provide any information and have not selected an investment option. He said that Mr. Hanna's analysis compared the glide paths for Great-West and T. Rowe Price, and T. Rowe Price believes they have a very good glide path, even if there are no fees taken into account, but even better when fees are considered. He said they agree that education is extraordinarily important. T. Rowe Price administers a large number of defined contribution plans, and all of them have an extreme emphasis on communications. They don't believe that education is only of interest to the default population; in fact, they are probably the least likely to benefit from it because they are very disengaged. It is a good idea to have a plan-wide educational program. There are web sites that provide a lot of information, and the Division of Retirement & Benefits can provide information at the plan level.

MR. SHIER inquired how other plans that value education and are taking steps to do that are paying for it. MR. DYER said there can be a basis point charge that is layered onto the expenses, or an explicit dollar amount for communication services that is added to the participant recordkeeping fee. It depends on how the plan is structured.

MR. SHRIVER stressed that the benefits listed for a target date default solution are really benefits to any investors in the target date funds and have been available to the participants since 1996. The target date funds are broadly diversified portfolios at all points, from enrollment into and through retirement. The T. Rowe Price asset allocation team not only designed these portfolios but they manage them on a day to day basis (Notzon and Shriver). They implement the glide path on an ongoing basis as it transitions from 90% stocks 25 years before retirement and then gets more conservative over time. They make the moves on a quarterly basis, so that means there are not sudden shifts in transitioning from one profile to another that could work against a person's long-term savings objective.

MR. NOTZON explained what could happen if there was a bear market when a person made a significant shift down in their equity exposure and it turned to a bull market - there would be a real loss. The opposite could be true. But T. Rowe Price does not want to look for random advantages and disadvantages, they want everything to be based on

analysis. Once a fund starts down a glide path, they make very tiny shifts every quarter.

MR. SHRIVER again mentioned that there is no asset allocation investment management overlay fee, and that target date funds are a low-cost, attractively priced option. A lot of thought has gone into making the target date funds a safe harbor qualified default investment alternative, but they have attractive attributes that make them a good default option across the full defined contribution landscape.

With regard to design of the target date portfolios, MR. SHRIVER said they were made with the default participant in mind - an individual who makes no decision today and potentially doesn't make another investment decision over the next 70 years. T. Rowe Price has received very strong recognition within the industry for their target date funds structure and the thought that goes into the glide paths. It was recognized by Morningstar as one of only two of their analyst picks, a high distinction. T. Rowe Price has done rigorous testing in terms of trying to quantify the glide path capabilities in meeting long-term retirement goals. Mr. Hanna's independent analysis reached that same conclusion and did it on an apples-to-apples basis, in terms of probability of success and other measures such as residual value in the account.

MR. BIRCH said T. Rowe Price has a 15-year relationship working with the State to continuously improve the investment options offered to the participants of the various defined contribution plans. He said that adopting the proposed target date funds will continue that legacy, with state-of-the-art offerings for the default participants - those who might be characterized as potentially most vulnerable and least suspecting of high fees or any other surprises. Even though the State is not subject to the specific provisions of the Pension Protection Act, clearly its identification of target date funds as one of the safe harbors ought to provide some comfort to the Committee, and ultimately to the Board, in selecting target date funds as the default option for this group of participants — specifically funds that utilize greater equity exposure when participants can accept that risk and far less equity exposure at times when they cannot. The transition is gradual through time so none of the participants are susceptible to an adverse market event in having just made a significant change in allocation prior to that. T. Rowe Price recognizes that one of the considerations that the ARMB has to take into account is communication and education, and obviously a large number of Alaska participants in the plans are familiar with the Alaska Target Date Funds, and presumably that would work as a key advantage in terms of accelerating adoption of those vehicles as the default options. Lastly, cost is always an ever-present consideration. Hopefully, the Board would find the offerings the way they have been designed and modified through the course of the relationship with the state pension fund to be a very attractive, low-cost solution.

COMMISSIONER KREITZER said she has very specific concerns as Commissioner of the Department of Administration that participants who are not making investment

decisions are not dumped out at the end of their career without enough saved for retirement. She said she was not sure today that she knew exactly what the answer was, but she wanted T. Rowe Price to understand that that was her very specific concern. Whatever this Committee winds up recommending to the ARM Board, she would state her concerns about that, that moving forward, looking at the information that she has seen in terms of where the U.S. is with regard to savings (some information she saw yesterday), she still has great concerns about not providing education to the employees.

MR. NOTZON replied that they could not agree more about the emphasis on education. T. Rowe Price is even more concerned about another factor, which is that someone who has been disengaged from the investment process throughout their career, it is actually imperative that they get some education prior to going past the retirement date. The whole industry has focused on these transition people — for somewhat mercenary reasons because there is a big block of money coming with the Baby Boomers. It is not an all altruistic concern. But there is a lot of information becoming available that can be provided at very low cost. It is a very important decision. If a person decides to take a check and buy a boat, they have no retirement. They have to understand that if they have been working for 40 years they should stay on the same path for the next 30 years and don't take out too much. So T. Rowe Price shares the Commissioner's concerns: it is not just a public plan issue, it is a national issue.

MR. BIRCH stated that that is why so many plans have gone to these options, because participants who were not making the elections were in a money market fund and stable value fund. Even if they were saving the maximum amount, their investment returns would not allow them to have the retirement that they thought they were going to have. So the whole industry, by providing these target date funds, and the Pension Protection Act providing some guidance on it, gets at least those participants into diversified portfolios where they can accumulate a much better balance over time. Combining that with education, that seems to be what the state of the art is, in terms of the charge that T. Rowe Price was asked to discuss.

3. Division of Retirement & Benefits

MR. SHIER stated that the Division of Retirement and Benefits (DRB) is in a contractual relationship right now with Great-West. DRB places great value on the idea that the State has more than an "Oh, well" attitude about putting participants who do not make a choice into a default, at least in the early years. There has been discussion about expenses, if somebody never engages, that 50 basis points is too much money going forward. If somebody absolutely refuses to engage, the best plan would be to get as much money working for them the best way possible for as long as possible. That is not in dispute. But to reach out and grab people by the necktie and get them engaged in their retirement planning becomes imperative. And somehow that has to be paid for. Does it make sense to assess the individuals who are coming into the plan and say this

is your investment and you're going to pay for it? The employer is paying for it as well. If somebody comes into the plan for three years and then leaves, the management fees currently are \$155.00 on average, per the spreadsheet example that Great-West provided. Who pays for that? The employee paid for some of it, and the employer also paid for some of it. If that person did not engage, then everybody failed. If that person did engage, and they leave, they have some tools that maybe the private sector was not interested in.

MR. SHIER noted that the Commissioner has mentioned that particularly for the public sector there are already a number of state workers that are working two or three jobs. You can run into half your staff at the Fred Meyer store in Juneau. The great concern statewide is that people are going to be out of public service, taking the reins of their retirement decisions and doing something with it. If the state can invest some amount of money in doing that in the early years, the Division is committed to doing that already with some of the administrative funding and is seeing encouraging results. The recordkeeper's seminars are booked up less than an hour after the DRB advertises them by email. A lot of these are defined benefit plan participants, and it's good that they are there. Some of the people are defined contribution plan participants, and \$15 million has been deposited into the DCR plans already (\$10 million in PERS and \$5 million in TRS). Also, money is coming in from outside when new State employees roll over money from a previous employer.

MR. SHIER stated that another thing that DRB is hearing from individuals is that they don't want to talk to anybody who can make a buck from it. For years seminars were scheduled in Anchorage, Fairbanks and Juneau — and will continue to be scheduled, perhaps outside those areas as well — where Smith Barney and others would will show up to tell participants how important it is that when they retire that they bring the investment firm the check. These firms provide a valuable service for a fee. However, some individuals have expressed that they are not sure they can completely trust these investment people to have their best interests at heart when they are making a commission on the program. So how can they do it? Either engage by selecting those products that are available, managed accounts, even if it was not the default. Or DRB could point them to some fee for service provider, and they could make that decision. At the end of the day, the Division is going to administer the plan, and it will take some guidance from the ARM Board. The Division's recommendation it to remain somehow in a default situation where the State reaches out to people and tries to make them engage. If at some point down the road, the State has to quit spending money on them and move on, that is fine. But he would like to make it an expectation that if someone goes to work for the State of Alaska that they will be expected to engage themselves in planning for the future. The State will not only provide the tools for that, but through other processes, such as reaching out to the employers themselves, the employee must — in order to get an acceptable evaluation perhaps — demonstrate that they have engaged at some level (listened to a seminar, talked to somebody, done the minimum)

in order to be ready for the future.

COMMISSIONER KREITZER said she appreciated Mr. Shier's vision, because the State is trying to do everything it can behind the scenes to help show people what the situation is for their retirement. The average age of a new State hire is 39 years of age. The average time a person stays with the State is 10 years. She said it concerns her that the State provide adequate education to people coming into the State system. People come to work for the State because of the stability it offers. She heads up the Executive Working Group dealing with recruitment and retention, and the State providing stability is a recruitment tool. She sees the education opportunity as another recruitment tool and not necessarily something that a person would get everywhere they go. It also could be something that helps the State keep employees, that they would know they have a stable future because of an encouraging environment for saving for the future.

MS. LEA stated that in her position she has literally talked to thousands of participants. Her first experience as a retirement technician was to tell a 65-year-old man that he had no income and no health insurance because his benefit had stopped because of an option he had chosen 20 years before — and he had to go back to work. When she looks at the defined contribution plan (DCR) participants, she does not see the security that was there for the defined benefit participants. The option that the aforementioned gentleman had chosen went away about 20 years ago, so there is no one in that position anymore. But it is possible to have DCR participants who at some point, if they are not engaged in planning for their retirement, will wake up one day and find they will not have enough money and have too much life left. She said she wanted the Committee to not just choose a good option but the best option for these employees.

MS. LEA said there was an idea put forth at the last meeting about keeping the DCR participants in managed accounts for a certain amount of time and then if they don't engage putting them in the target funds. That sounded to her like the best option, because the Division's goals are not just to have the participants know where they need to go to reach a successful retirement income, but they need to know where they stand today in comparison to where they need to go, so they can make those changes along the way. The Division's goal is to have an engaged employee. In the past it was not necessary to have the SBS employees engaged. They had the security of that defined benefit plan. The DCR employees do not have that. They have an opportunity to have a terrific retirement if the ARMB and the Division give them the tools. But the first thing to do is to engage them. The use of the managed account service for a period of time when people first enter employment is the best way to get them engaged, where they can get at least a couple of report cards to show them where they are. The Division's goal is to provide as much education as possible, in partnership with Great-West, both in basic savings and in financial education. It is the Division's thinking that those people in managed accounts can choose to move to Great-West's advice service or the

guidance service in the future because they will be getting the education to do that. If they never engage, the target date funds are an excellent vehicle for them — low cost, and it will get them close to where they need to go.

MS. LEA encouraged the Committee to keep the participants in mind. She said most of them are not as sophisticated as the people in this room. She has talked to many, many people who are very afraid of financial jargon and who are so relieved when told there is a service in which somebody can do it for them. That has been the Division's experience in the last year with this plan - relief on the part of the employee. Either that there is someone who can do this for them forever, or someone who can do this for them for a while until they are in a position to do it for themselves.

MR. WILLIAMS said he was also a firm believer in a retirement plan participant being actively engaged in their retirement planning, or even if not actively engaged, that they at least have received education, and that at age 65 they will have sufficient money to retire. He said he shares the Commissioner's concerns along that line and has expressed that sentiment at previous meetings. Currently, there is the managed account option where there is some ability to get education and be actively engaged in retirement planning. He asked, if the ARMB changed the managed account option, if there was anything in place from the Division's perspective that could quickly fill the education void.

MR. SHIER replied that they have actually thought about it. It will take money from somewhere to accomplish what the Division would want to do. The contract with Great-West was accomplished over a year ago after negotiations, and how to pay for the services for people coming into the plan was addressed in that contract. If the process is changed materially, then the Division will have to go back to the table and find some other way to do that — whether that is a broader assessment across the funds or some other way. But if nothing else, this review process has highlighted for the Division the real difference in the education needed. He said he would argue that even the defined benefit plan participants need this education as well. He guessed that if the Division did not have the managed account option, they would have to renegotiate the contract because there are some price issues tied up in there, and then find some way to accomplish the education services through a supplemental appropriation or a request for additional assessment against the funds more broadly.

MR. WILLIAMS asked if the Division planned a performance review of the contract with Great-West and, if so, when. MS. LEA stated that the Division gets monthly reports from the Anchorage office representative about the number of people who attend the seminars and the types of seminars held. The Division surveys the participants also about the publications that Great-West sends out and people's satisfaction with the seminars. There is also a monthly meeting about the recordkeeping side of the contract with Great-West. So the reviews of the contract are ongoing rather than annual or every

six months.

MR. SHIER stated that the Division is always interested in value for money, and they will be following performance closely. If they are not getting the desired result, they will not continue to keep doing it. The Division is looking at how it trades data between the data processing shop and Great-West because there are expenses associated with that. Great-West and the State have enjoyed a long association, but if someone comes in later and has a better product or better value at the next RFP, it is a competitive environment. The State is doing that with its health provider, which was changed last year, and that constant monitoring will continue with all the services that the State buys on behalf of its beneficiaries.

CHAIR TRIVETTE inquired about the cost of the contract with Great-West. MS. LEA indicated she did not have that information at hand. MR. CHRISTIE stated that Great-West does all four retirement plans for the SBS, however, the bill in the last month for the two new plans was about \$1,000 because there are few assets there yet. Great-West will not really start making money on the service until the asset balances accumulate over a few years.

4. Department of Revenue

MR. BADER stated that he agreed with Mr. Christie that Reality Investing, Great-West's managed account service, is a service - and an important service for the participants in the retirement plans. But what the Committee is talking about is an investment decision, not a service. The service can be provided independent of the investment decision, and staff's analysis was based upon what is the right investment default option for people to be in.

MR. BADER next addressed some of the ARMB staff comments and conclusions brought up in the Great-West summary. Regarding point #1 on page 3 that talked about whether or not the Great-West asset allocation is more or less conservative than T. Rowe Price's, he said Mr. Hanna's presentation never represented that there was a significant difference between the two asset allocations. Mr. Hanna's presentation had stated, "Probability of success is not significantly different." But since there is a characterization by Great-West that their asset allocation is essentially more conservative, everyone agrees that if one takes less risk they earn less money. From page 7 of Mr. Hanna's presentation, MR. BADER pointed out that at the beginning the Great-West asset allocation is more risky, then for a long period of time it is less risky, and during retirement more risky (since they do not have a declining glide path like some of the other funds do). However, staff does not believe, through the modeling, that risk is significantly different.

MR. BADER stated that staff believes, from an investment standpoint, that fees are very important. Great-West did not take exception to the numbers that Mr. Hanna had

reported, rather they recharacterized them by putting the present value of the fees in their response to Mr. Hanna's work. He said that staff also takes exception to some of the assumptions embedded in Great-West's work. He asked if someone at the table would write a check for \$5,000 today to have the lifetime access to the Reality Investing managed account services plan. He said the answer is probably no. Great-West is saying that the present value of the service is between \$1,200 and \$5,000.

MR. BADER said it appears that the conversation is shifting to not making a lifetime commitment to the managed account service, that if people do not access it at some point, there would be an agreement to do something different for those people after three years. He noted that one risk in that schedule is that the Great-West asset allocation is 100% in equities, whereas the industry and T. Rowe Price have lesser allocations to equities. If the ARMB adopted a plan of putting new employees in the current default option for three years and then, if there is no activity, participants would default to a target date fund. That may or may not be a good idea, because one of the benefits in target funds is a glide path that is consistent. If it happens to be at a time when the market has experienced poor performance, and the transfer from the Great-West managed account service to a target fund gives a person a lesser allocation to equities, they have missed their opportunity to get the rebound in the market. Target date fund glide paths are for long-term investments. If the Committee wants to go to a cut-off point for the managed account default if the participant does not engage at all, MR. BADER suggested directing staff to investigate ways to mitigate the impact of a large change in asset allocation. Ibbotson and T. Rowe Price and the whole industry agree that it is not right to make large asset allocation changes, and the proposal that has been brought up would result in a 10% change in a participant's equity allocation.

MR. BADER related that he talked to Mr. Hanna as he worked on his analysis, and every assumption was based upon input from either Great-West or Callan Associates. Staff did not make any independent assumptions about inflation or capital markets. He said he stands behind Mr. Hanna's work. Whether people want to look at the present value of fees or the future value, it is just a different way of looking at the same question. The Committee and the Board have an investment decision to make, and the decision does not have to be linked to whether or not participants are provided with information or education. There are other ways to do that. Even the Legislature, by approving two years of funding for participant education in SB 141, assumed that participants at some point would bear the cost of education. He said there was never any doubt in his mind that education is important and there ought to be a way to do it. But maybe picking an investment option is not the right way.

MR. BADER noted that Great-West's response had indicated that staff's September 25 presentation had said that "Contribution rates for TRS and PERS+SBS reflect satisfactory probabilities of achieving successful retirement outcome." He said that the Legislature picked the 5% contribution rate for PERS and 7% for TRS, not staff.

MR. BADER said he thought everybody wanted to get to the same place, and it was just a question of which vehicle was going to be used.

CHAIR TRIVETTE commented that the contribution levels the Legislature set were actually less than what was in current statute, which he found mind boggling. He said that everyone in the room recognizes there is a serious problem and a lot of work to do.

CONSULTANT COMMENTS - Dr. William Jennings, IAC

DR. JENNINGS stated that the Board's attorney, Rob Johnson, made a presentation at the Education Conference yesterday where he quoted the prudent investor rule as implemented in Alaska: "Amongst beneficiaries, the fiduciaries shall treat beneficiaries with impartiality." He said that during a lot of the conversations he has been struck by the cross-subsidizing. Clearly the people who are not logging in and giving data are subsidizing the people who are actually making use of the advice service. He questioned whether that was necessarily appropriate.

DR. JENNINGS said, "Education ain't all it's cracked up to be." There is data from the benefits world about how hard it is to move participation through education, if it is not an auto-enrollment system. The Division of Retirement and Benefits should want to do education, but it should calibrate its expectations properly. He said that it would be appropriate for beneficiaries to be paying for the education because they are benefiting from it, but he urged being aware of the legal constraints on doing that.

DR. JENNINGS said what struck him at the last meeting was the extreme activist participant. He noted that it is rare to have a participant attend and talk during the public member comment part of the meeting. He recalled that Charles Gallagher was agitated enough about the 50 basis points of fees to show up and comment on it at the September 25 meeting, yet he was unaware of his ability to opt out. He said that really struck him about the opt-in versus opt-out arrangement with the Great-West Reality Investing default program. There are two other options in Reality Investing that are lesser levels of service — investment advice and investment guidance — and which cost less, the advice service being \$25 a year. Those are things that could legitimately be part of a program.

DR. JENNINGS stated that from an investment point of view the fees are the thing to focus on. A \$25 fee versus a \$5,000 fee in present value terms is a massive difference. There are ways to tease people into being engaged or to attain the DRB director's vision at significantly lower costs.

Lastly, DR. JENNINGS said that two years of managed advice is almost certainly not equal to a 50-basis-point advice kind of arrangement, and to think about the balances that would be in there for the first two years. Going back to the original point, they are

presumably thinking about the inertia effect and that the balances will build up and there will be bigger and bigger fees. That changes the thinking about going with a managed account service for a short term. That number is probably different than what this group is thinking about at this point, and that would probably change the calculus of a compromised position of going that route. He said he presented his view at the last meeting that the new era of target funds, because of the costs, are the appropriate default investment option. Over the presentations and over the interactions, the Great-West advice offering has become more attractive to him, but that should be an opt-in option as opposed to a default option.

MR. SHIER said that he has been concerned about cross-subsidization in both health plans and retirement plans since he became involved on advisory committees in the industry in 1992. He asked for comment on the idea of the State asking individuals to bear the cost of outreach as they come into the system. Then if they fail to engage, the State defaults them out to the lowest possible cost target fund, as opposed to assessing all members the full cost for a period of time and then simply making some statement after 24 or 36 months that the State would not try to reach out to them anymore in the program. So instead of subsidizing those people any longer, the funds could be used elsewhere in the program. He wondered how to assess the whole body of individuals for the full court press up front. Those who would select into the managed account service would be paying their own fees, and the State is not so concerned about them because they are doing the right thing, and maybe they think the 50 basis points in fees is value for them. He asked if it was appropriate to charge people directly for the full court press, that effort to bring them into the fold of informed investors and engaged individuals. And then banish them to the unsubsidized flat fee target fund and not spend any more money on them, but they would not be assessed any more for those services.

DR. JENNINGS said it was a tension between two aspects, that he was just highlighting the cross-subsidization issue because it troubles him. An overall education program is a legitimate part of the overall administrative expense. Other than that, he would defer to the Director's kind of expertise and what type of plan other states are using. For example, the federal plan is very inexpensive, but it is rolled into the overhead — there is occasionally a CD with an ability to model and that sort of thing, and the federal government has been upgrading the web sites with security, etc. Those are non-investment expenses that are essentially assessed by the federal entity equivalent to the State's DRB.

COMMITTEE ACTION

MR. BADER indicated that staff's memorandum in the packet included the following recommendation: That the Committee recommend to the ARM Board that age-based target date funds be the default option for defined contribution retirement accounts and SBS, and that staff return to the Committee with details of an implementation plan to enact the new default option no later than July 1, 2008.

MR. RICHARDS commented that DRB Director Shier and his group are in a Catch-22 situation about talking to participants. Commissioner Kreitzer's plan to put the retirement account monies in a report can be a good thing, but sometimes keeping the sum out of a person's mind so they are not tempted to think how they can spend it also has some value. It is hard to decide what to do, but he fell on the side of having people know exactly what their financial situation is periodically. He said he liked what Dr. Jennings said about education being a legitimate plan expense so that people can leave state service after 30 years and have a good life. He favored stressing to members the economies of scale that can provide lower fees and that sticking with the State is a good way to go. He said Mr. Bader and the investment management group have done a good job by the retirement funds. So he supported staff's recommendation but wanted the education to be part of what the State does to make sure that employees do the best they can with the amount of money they get through wages and benefits.

When the Chair asked for a motion, MR. WILLIAMS commented that it appeared no one wanted to make a motion that was mutually exclusive by going with the target fund route and throwing out managed accounts. He said that for the short term managed accounts might be necessary until the ARMB and the Division of Retirement and Benefits come up with some other alternative for an education component and how to do that transition. Right now that education component is served through the Great-West managed account service. So he advocated rewriting the recommended motion to include some transitional language before he could make or support the motion.

CHAIR TRIVETTE stated that he was a strong supporter of the value of education. He spent a lot of time training people in the state and elsewhere in the country, and he knows there are sometimes better ways to educate. He said the Board would be derelict in its duties if it did not include retirement education for the plan participants. He said he asked Mr. Bader for the staff recommendation the way it is written because he thought the Committee had to deal with the investment option first and then plan for the education component, which is separate. The two things go together, but there is no easy way to do it in one sentence.

MR. WILLIAMS asked if the Chair envisioned the Committee's report to the full Board including a recommendation to seriously review the education component and to have an orderly transition.

CHAIR TRIVETTE said yes, that he supported the target funds as the default option because of decisions the Board made recently, such as changing the glide paths for the Alaska Target Funds, as well as the information received about where defined contribution plans seem to be headed with target date funds. He said he thought of education, advice and guidance as a service that is separate and apart from the investment decision, and that service is critical for everybody. He said he appreciated

Dr. Jennings pointing out what Rob Johnson said yesterday that participants have to be treated equitably - if a fee is charged across the board and only 4% or 5% are using the service, then those not participating are paying for the few who are using it. That may be a issue for the Committee to be concerned about. It is the Committee's job to recommend to the Board a default investment option, but it also has to figure out the education component.

MR. RICHARDS expressed his belief that the last line of the staff recommendation that "staff would return to the Committee with details of an implementation plan to enact the new default option" took care of some of Mr. Williams's concerns about the details.

MR. BADER said the reason why the recommended implementation date is July 1, 2008 is to explore with the Department of Administration possibilities for providing the education service to participants and funding it differently. It allows for accessing the legislative process, if that is required, and time to bring a plan to the ARMB. If the decision were made to call the education service a plan expense, there has to be appropriation authorization to change the administrative fee. But it is non-general fund.

COMMISSIONER KREITZER commented that it is almost two late in the budget process to be making any changes and she preferred not to make a request at this point.

MS. LEA clarified that just because the Great-West managed account feature may not be a default option does not remove the financial education component. It is not all-or-nothing. But it would require DRB to renegotiate costs, because she did not know how much of the defined contribution plan education costs are embedded in the managed account costs. The financial education services are actually billed separately under the contract with Great-West.

CHAIR TRIVETTE reiterated that the Committee needed to first come up with the best investment vehicle for a default option. Right behind that, but equally important, would be the educational component. He said he thought about the default option in terms of his own son and other young people working for the State now as to what would be the best for them. He said he appreciated Great-West's efforts in trying to engage people in their own retirement planning, but they would have had a hard time engaging him when he was 21.

COMMISSIONER KREITZER reminded everyone that the average age of someone starting work with the State is 39 years.

CHAIR TRIVETTE said he understood that, but there are a lot of people returning to work with the State because they are Tier I and Tier II. He guessed that in another five to eight years the starting age at the State would be much younger. He said he has

talked to supervisors who tell him there are a lot of fairly young people trying to get jobs with the State.

COMMISSIONER KREITZER said that counts the interns, but she maintained that the starting age currently is older than people think.

CHAIR TRIVETTE commented that in terms of investment advice and development of funds, T. Rowe Price cannot be beat. He added that he might have thought differently if T. Rowe Price funds were possible as far as a Great-West investment. But the Committee is dealing with the program the way it is now.

MR. WILLIAMS said he wanted to hear from Director Shier about alternatives from other sources.

MR. SHIER suggested that this discussion be held with strictly the Committee members and board staff in the room, in order not to jeopardize any negotiations in the future.

Executive Session

MR. WILLIAMS moved that the Defined Contribution Plan Committee meet in executive session to discuss matters that could affect negotiations and potentially impact finances of the State of Alaska. MR. RICHARDS seconded.

The Committee met in executive session starting at 11:00 a.m. They returned to regular session at 11:08 a.m., and the Chair reported that the Committee took no action during executive session.

MR. WILLIAMS moved that the ARMB Defined Contribution Plan Committee recommend to the ARMB that age-based target date funds be the default option for defined contribution retirement accounts and the Supplemental Benefit Plan, and that staff return to the Committee with details of an implementation plan to enact the new default option no later than July 1, 2009. MR. RICHARDS seconded.

CHAIR TRIVETTE stated that the Committee was changing the date for enacting the new default option to 2009 because the 2008 date might not be feasible for the Department of Administration. Plus, the Committee wants the education component to continue, which they understand it will be in the meantime.

Roll call vote

Ayes: Williams, Richards, Trivette

Nays: None

The motion passed unanimously, 3-0.

FUTURE AGENDA ITEMS

MR. BADER said Mr. Williams had indicated an interest in pursuing the possibility of making the defined benefit plan asset allocation an investment selection for the defined contribution plans, to give the participants the same types of investment returns. There are a lot of legal considerations and indemnifications involved, so it is not a simple task. *[Possibly by the February meeting]*

OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

MR. WILLIAMS said he was impressed by the presentation on looking at real estate in a defined contribution plan portfolio. He asked that the Committee explore that in the future, either as part of the target date funds or stand-alone.

PUBLIC/COMMITTEE MEMBER COMMENTS

MR. SHIER remarked that he was pleased and impressed with the collegial nature of these difficult discussions — the participation by the State's contractor Great-West and by the investment people at T. Rowe Price, as well as Mr. Hanna's and Mr. Bader's analysis, and Kathy Lea's input. It is a tough discussion because there is a lot of emotion and strong feelings attached to it. He said he was grateful to be part of the process.

CHAIR TRIVETTE said that this review process has been long and involved, and he felt comfortable that the Committee has met its standard from a fiduciary standpoint. He thanked the many players for their input that helped the Committee make its decision.

MR. BADER expressed his appreciation to the Department of Administration people for working on this issue. He noted that Great-West has a big stake in the outcome of the investment default decision, and they have maintained their professional bearing, as has T. Rowe Price. Most importantly, the Committee has been very deliberative, gotten all the information, and not rushed to any conclusions. He said he appreciated being part of the process in working with this Committee.

ADJOURNMENT

The meeting adjourned at 11:16 a.m., on a motion by MR. RICHARDS.

Note: The summary minutes are extracted from staff's tape recording of the meeting and are prepared by an outside contractor. The tapes of the meeting and the documents reviewed and discussed at the meeting are on file at the ARMB office.

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