State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
SALARY REVIEW COMMITTEE MEETING

Commissioner's Conference Room, Room 1820
440 W. 7th Avenue
Anchorage, Alaska

August 10, 2007

ATTENDANCE

Committee Present:	Martin Pihl, Chair Gail Schubert Commissioner Patrick Galvin
Committee Absent:	None
Revenue Staff Present:	Brian Andrews, Deputy Commissioner Gary Bader, Chief Investment Officer Julie Pierce, State Comptroller Judy Hall, Board Liaison
Others Present:	None

CALL TO ORDER
COMMITTEE CHAIR MARTIN PIHL called the meeting to order at 10:12 a.m.

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

PUBLIC MEETING NOTICE
JUDY HALL confirmed that the meeting was properly noticed.

APPROVAL OF AGENDA
The agenda was approved as submitted, on a motion by MS. SCHUBERT and seconded by COMMISSIONER GALVIN.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES
There were no members of the public present.

REVIEW PROPOSED COMMITTEE CHARTER

MS. HALL explained that this was the first time this committee had met as an ARMB committee. The process has been for committees to draft their charters and submit them to the full Board for approval at the next board meeting.

COMMISSIONER GALVIN commented on the appropriateness of the Commissioner of Revenue sitting on the Salary Review Committee, saying it was a strange loop where the Board makes a recommendation back to the Commissioner. He thought there might be a perception of the Commissioner having a greater hand in what recommendation actually comes back to him or her, or the possibility of not being able to fully participate because of the awkward position.

MS. SCHUBERT explained that in the past the Board wanted to involve the Commissioner of Revenue in order to ensure there was buy-in on any recommendation. She said that the Commissioner's points were well taken, however.

COMMISSIONER GALVIN said he did not have a problem participating fully in the Committee's discussions, but it seemed odd to him.

CHAIR PIHL stated that as a practical matter he has seen the deputy commissioner as the active person with the Committee. He thought it was up to the Commissioner how he wanted to be represented on the Committee. *[COMMISSIONER GALVIN later mentioned that the way the ARMB is structured he cannot delegate his role on the Board to anybody.]*

MS. SCHUBERT said the intent of having the Commissioner participate at the Committee level was to not blind-side the Department of Revenue with a salary recommendation. She said maybe the Commissioner could participate unofficially rather than being an actual Committee member.

COMMISSIONER GALVIN said he understood that he was not obligated to follow the Board's recommendation, but to the extent that he, as a Committee member, might approve a recommendation to himself, then it would look strange if he did not follow it through. He indicated that he would discuss this with the full Board when it reached that point, but he would participate in today's discussion and abstain from voting. That would keep the process going forward for now, but he would be more comfortable if the Salary Review Committee was comprised of three board members who could participate fully.

GAIL SCHUBERT <u>moved that the Salary Review Committee approve the Committee Charter and recommend it to the full Board for approval</u>. COMMISSIONER GALVIN <u>seconded</u>. The motion carried unanimously.

REVIEW TALKING POINTS

Deputy Commissioner BRIAN ANDREWS stated that in the seven months he has been back he has seen the personnel in the Treasury Division as being very professional, dedicated and competent in their work, and he was proud of them. He reported that Julie Pierce, the State Comptroller, was leaving August 31 to take the chief financial officer position with a local bank. The State Comptroller position has been advertised nationwide. The Asset Accounting Section staff does a tremendous amount of work, with four retirement funds, the new defined contribution plans, and 30-plus different portfolios and accounting entities in the general fund. There are also alternative investments now that are not easy to account for, plus all the compliance functions.

MS. SCHUBERT asked if the salary and benefits had anything to do with Ms. Pierce's decision to leave the Treasury Division. MS. PIERCE replied that it played a small part, that because she was at the maximum pay range for the partially exempt position she would not be getting a pay increase until 2012. MR. ANDREWS added that it will be tough to hire a new State Comptroller for around $100,000 a year.

CHAIR PIHL said he was disappointed that Ms. Pierce was leaving, and he thought the whole ARM Board was very concerned, as was the former Alaska State Pension Investment Board, about the staff turnover in that area. He mentioned Betty Martin, Susan Taylor and Charlene Morrison as people in comptroller positions who have left. He said there is something wrong with the pay structure for the comptroller positions in state government.

MS. SCHUBERT commented that that was particularly true if a bank can pay more than the State, because the banking industry is known for not paying their employees very well.

COMMISSIONER GALVIN suggested proceeding with the agenda before talking about the strategic approach for resolving some staff turnover issues, because the problem is statewide and not isolated to the Treasury Division or the Department of Revenue.

COMMITTEE DISCUSSION RE: FY09 SALARY

MR. ANDREWS read some excerpts from an article in *Fund Fire* related to proposed incentive bonuses at the Massachusetts Public Pension Fund and other state funds. The article stated that among all public pension funds of one billion dollars or more the median increase in the 12 months ending June 30 has been 17.69%. Another article in *Fund Fire* reported that according to the Greenwich Associates Study released last year the average compensation for a public chief investment officer was $128,000 in 2005. The mean salary for a chief investment officer at a corporate plan with more than $5 billion was $229,000.

MR. ANDREWS drew attention to the organizational chart of the Treasury Division in the meeting packet. He explained that the positions denoted by green boxes are exempt status employees who work at the discretion of the administration, and there is no formal compensation scenario for these people. The yellow boxes — the deputy commissioner and the state comptroller — are partially exempt, as is the commissioner. The white boxes denote classified people that are in the state system and their positions are reviewed with class status and merit increases. He said the Treasury Division does more than just investment activity and accounting activity for the retirement funds. The Division also acts as the state's bank, does all the cash management responsibility for the state, and is responsible for the issuance and monitoring of the state's debt. The shared functions between the general fund and the retirement systems all reside with the Treasury Division.

MR. ANDREWS next reviewed a spreadsheet showing the current and prior year salaries for certain people in Treasury. He noted that these positions were given a 3% raise on January 1, 2007. He said that compensation has not been ignored in Treasury over the past four years, and prior management gave increases all along. In most cases, there were pretty healthy increases.

MS. SCHUBERT asked what the rate of inflation has been. MR. ANDREWS said on average about 3%-3.5%. MS. SCHUBERT observed that a 3% increase was not really a raise then. MR. ANDREWS agreed it was just keeping up the employees' purchasing power.

CHAIR PIHL said it did not appear that the increases in the interim years addressed the inequities that were dealt with in 2004 because the salary increases for the comparable positions went up even more.

MR. ANDREWS referred to a spreadsheet entitled "Market Compensation Benchmarks" that compiled salary information from various sources. He noted that Fox Lawson is currently conducting another salary survey for the Alaska Permanent Fund Corporation (APFC) and will have that done by the end of August. The APFC has indicated they will share the results of that survey with the Treasury Division at no cost. He said the spreadsheet gives the Committee an idea of what Treasury is competing against in the market, salary-wise.

MR. ANDREWS presented a spreadsheet entitled "Treasury Salary vs. Peers" showing the investment and accounting positions at the APFC and Treasury with the corresponding salaries. This information was also depicted on a graph for a visual comparison. He explained that as a starting point he also included a column of what he considered were competitive salaries for the positions. He noted that the total amount of increases represented in the recommended competitive salaries came to $144,000 for the year.

MR. ANDREWS stated that salary for people working in the Treasury Division has two budgetary sources — the ARM Board and the general fund. The cost allocation program in the past has suggested a 65%/35% split between those two budget sources. He said that this fall management will be re-examining the cost allocation program because there may be some inequities in it.

MS. SCHUBERT stated that when Bill Corbus was chair of the Alaska State Pension Investment Board and Darryl Rexwinkel was Commissioner a new law almost made it through the State Legislature that would have made the pension system independent, but the bill got held up on the Senate floor at the last hour. The intent of the Board, as it was then constituted, was to give the Board and the staff more freedom, including the ability to pay its staff better. To the extent that the ARMB can free the Treasury Division up to pay people more, she said she strongly advocated for that, because "you get what you pay for." The ARMB has really good investment results because it has a dedicated staff of people who feel strongly about public service. She said her fear has been that people who perform services for the ARM Board would go out and get better paying jobs elsewhere.

MR. ANDREWS said one thing to look at is having individuals take sole responsibility for ARMB functions and be paid entirely by the ARM Board. That would allow better compensation for those people. He said the problem with that is that other individuals would have to take over solely general fund activity. There would be a real management and morale problem if the Treasury Division people working on ARMB responsibilities received raises and the other exempt positions in cash management and the debt area were ignored.

CHAIR PIHL mentioned that by resolution in 2004 the ASPIB Board was willing to accept more of the cost in order to resolve the pay inequity in Treasury.

MR. ANDREWS said another thing that management will look at this fall is whether a bonus program would work.

MS. SCHUBERT expressed support for that idea and said she uses it for her business development people. It works because people are incentivized to bring in work that has to be profitable. She also commented on a conversation she had with someone on a plane recently about state leadership being grossly underpaid, which may have led to the problems that some of the legislators are facing. From some of the facts that have been released, it appears that many of the legislators in question had pretty heavy debt loads, which may have led them to make decisions that they might not otherwise have made. She recognized that that was not the ARMB's responsibility, but she felt that something needs to happen.

MR. ANDREWS referred to the executive level salaries at state agencies and corporations compared to, for example, the Revenue Commissioner's salary, which is not consistent with the level of authority and responsibility that the Commissioner has versus that of some corporation executives. He said the salary "race" among executive directors in state corporations does not bode well for general government.

COMMISSIONER GALVIN stated that it is understood in accepting a state position that it is public service that will not have the same level of compensation as the private sector, but there will be some intrinsic value from that work. He agreed that it is difficult when there is such discrepancy between the positions that are trying to compete with the market and the positions where the salary is set by the Legislature. He said that on the other hand he understood that state corporations and agencies are trying to attract the best people they can find and trying to pay competitive salaries.

CHAIR PIHL inquired about the commissioner pay level and the date of the last increase. COMMISSIONER GALVIN replied that he was a range 30, and the governor raised commissioner salaries substantially within the last four years.

COMMISSIONER GALVIN related that when the state departments submitted their transition reports at the beginning of the Palin administration the number one issue for almost every department was compensation and retention. It was recognized that the state as an employer was no longer seen as competitive. Not only is the state lagging behind the private sector in terms of base salary, but the benefits that were previously very attractive have eroded over the years. Even setting aside comparisons to the private sector, state government salaries are far behind those of the federal government. In that kind of an environment, people who are vested in the state system will stay until they reach their maximum value for retirement and then leave for better pay elsewhere. Then the state is not able to hire replacement people to work at the level that the previous people were working at. So the state is facing a pending crisis because there is an unbelievably large percentage of its staff that is within five years of retirement. There are not people ready to fill in, and the state cannot bring people in at the salaries that are being offered. So the best the departments can do is bring in entry level professionals, and they almost invariably are gone within three years once they are trained and become attractive to the private sector at significantly more pay. Even a 25% pay boost across the board would not avert the crisis because people will still be retiring. The administration is close to signing an executive order to say this is a serious crisis that a cabinet level team will address and try to work out long-term solutions. Part of that will be increasing compensation, and other factors to look at will be recruitment and benefits, etc. So there will be some action in the next couple of years to take fairly aggressive action, but that will only raise everybody incrementally a bit.

COMMISSIONER GALVIN said the challenge of looking at the issues in the Treasury Division is to see where they are so far out of step with the market and competition for the positions that even with an across-the-board raise the Division will still be behind the curve, and where they can be most effective in taking action to recognize Treasury's unique issues and working to shrink that gap so that when the state takes a more comprehensive view the Division will be keeping up and not still lagging behind. He said he was supportive of the Committee's discussion in identifying where changes have to be made within the exempt positions in order to catch up to the market and hopefully keep up with the market. In the end, the administration is getting hit from literally all sides by this — from Transportation, trying to recruit and retain their engineering staff to the Natural Resources Oil and Gas Division technical positions that are in demand elsewhere in the oil and gas industry. Every sector of government has its challenges, and the Treasury Division has to be aggressive in communicating and advocating for its employees.

MS. SCHUBERT wondered if there was anything people could do as private citizens to help. COMMISSIONER GALVIN said the business community can provide a tremendous amount of help by going to the Legislature and talking about the state not doing what it needs to do to succeed, which will ultimately reflect on the business community's ability to succeed. Business leaders can implore the Legislature to do something before everybody suffers, and this will give legislators the macro/political view. There has been a government worker bashing generation with pressure across the board on the political side to take the position that government workers are overpaid and that government in general is bloated and needs to be cut. The political governmental reaction has been slow to recognize that we are past that point. It is time to turn that around and shift compensation back up, but it will take a lot of work. The political climate seems to be changing to allow that to happen.

COMMISSIONER GALVIN stated that he and Mr. Andrews have been working to identify how the Treasury Division should go, and he has started talking with the Governor's Office about what he would like to do. The question will be meshing that proposal with the comprehensive direction that the administration is going to want to go in. Treasury's strategy is to emphasize the unique needs of the division and explain why they need action beyond just the general action that the administration will be pursuing.

CHAIR PIHL said he hoped that the Commissioner would be emphasizing that the salary disparity in key Treasury positions goes back to 2004 and has only widened since then. He added that when the ARM Board was formed the Legislature charged the Board to see that funding was in place to meet benefits. There are only two ways to get there: by increasing contributions and by outstanding investment performance. The latter is in place, thanks to the chief investment officer and the investment team that he has built. He said he could not stomach the salary disparity continuing, but he appreciated the Commissioner's comments and hoped that the Board could get there.

He expressed the desire that the Deputy Commissioner's proposed salary increases could be effective July 1, 2007. He added that the problem of the state comptroller position being partially exempt by statute was another challenge. He said the Treasury Division cannot continue to lose key people like that.

MS. SCHUBERT mentioned that it might be worth exploring the ARM Board paying for some positions that would also provide services for general fund functions at a set cost to the state. If the ARMB were permitted to pay for positions devoted entirely to ARMB duties, this would eliminate the state having to hire duplicate positions to do general fund responsibilities.

MR. ANDREWS acknowledged that it was an interesting question that deserved some study. He said the key will be to look at the cost allocation program to make sure that it is more in line.

MR. BADER said he thought that when Senate Bill 141 passed it allowed the ARM Board to enter into agreements with other state entities to manage funds. So Ms. Schubert's question is whether the general fund could contract with the ARMB to manage the state's funds.

COMMITTEE RECOMMENDATION

CHAIR PIHL indicated that he supported the recommended salary spreadsheet prepared by Mr. Andrews, and he appreciated the Commissioner's support of it. However, he had some concern with the small increase proposed for the fixed income manager position and asked Mr. Andrews to discuss with Mr. Bader maybe making it a 3% increase or something. Similarly, for the $185 annual increase recommended for the assistant investment officer position, it was probably better to give no increase than to give one that small.

MR. ANDREWS mentioned that it might be possible legislatively to raise the state comptroller position from a range 27 to a range 28 or 29, which would give more breathing room to increase the pay.

COMMISSIONER GALVIN pointed out that in the last couple of years the Budget Committee has looked at the salary issue in the context of approving the budget. A resolution from this Committee could state a focused recommendation without specifying dollar amounts. Resolution 2004-07, included in the meeting packet, used the comparison to the APFC as a vehicle for identifying where the salary levels should be.

MS. SCHUBERT raised the question of including in the resolution the apportionment between the Department of Revenue and the ARM Board budget. She said that in the past the trustees have focused on the percentage of work that the investment staff was doing for the Board as opposed to the general fund and Treasury. That issue was raised a number of times because the trustees wanted to ensure that the pension funds were not being overcharged for their portion of the work that staff was performing. She said she thought that was fairly short-sighted because the pension funds benefit from the staff, and the staff are subject to a cost allocation program. To the degree that the pension funds can take more of the burden for the salary scale and structure, because of the enhanced benefit that the pension funds get from having this great staff, then that is what the Board should do. She explained that if the Board insists on paying 65% or 70% of the salaries because the staff spends that portion of their time working for the ARMB, and then those people leave for higher pay elsewhere and new people are hired who cannot produce the investment performance that the prior staff has done, and the pension funds lose two or three basis points of performance as a result, that can represent tens of millions of dollars lost. She said that is short-sighted, and the Board needs to step up and take more of the burden off the Department Revenue for paying the staff.

COMMISSIONER GALVIN pointed out that the resolved section of Resolution 2004-07 states that the Board is willing to absorb additional costs of compensation for the Department of Revenue employees who perform substantial work as staff to the Board. He thought that was a reference to a Board decision in 2004 that it was willing to absorb a greater percentage than designated by the cost allocation program. So wording along those lines in a new resolution would identify that issue as something to work on and see if it provided more flexibility and more cover for being able to increase salaries.

MR. ANDREWS explained that a constant problem politically has been the notion that retirement funds have been used to pay for general fund activities. So the Board has to be careful not to do that, particularly with an unfunded liability of $8.6 to $10.0 billion in the retirement funds.

COMMISSIONER GALVIN added that a rumor was nipped in the bud when it was raised during the transition that the ARMB had been overallocated costs associated with Treasury employees. The spin had been that the state was riding on the backs of the retirement systems to pay for staff that also worked on the other funds that the Department of Revenue manages. So as much as the ARMB is willing to step up and say it wants good managers of the funds and it would be in the Board's interest to subsidize the state to get them, that could whipsaw back and be seen as an inappropriate use of retirement fund monies.

MS. SCHUBERT said it might be a case of presenting the Legislature with a choice of either setting the ARM Board up as a separate entity that can pay enough to attract and keep the best investment people who provide stellar investment results, or stop tying the Board's hands in its efforts to make the retirement funds succeed and reduce the unfunded liability.

COMMISSIONER GALVIN said he understood the Committee wanted to use Resolution 2004-07 as the basis for a new resolution and update the whereas clauses to change the ASPIB to the ARMB. The first resolved clause would be updated to refer to the APFC pay scale.

Regarding the "75% of duties" reference in the second resolved clause, the Committee agreed to simply shorten the statement to "That the foregoing scale be applied to positions of the Department of Revenue analogous to positions in the Permanent Fund Corporation." This implied trust in the Department of Revenue to reasonably determine which Treasury positions are analogous with APFC positions.

MS. SCHUBERT expressed concern that the fourth resolved clause — about the Board being willing to absorb the additional costs of compensation — was too restrictive in its condition that the cost apportionment be reassessed.

There was discussion about shortening the fourth resolved clause to "That the Board is willing to absorb the additional costs of compensation for the Department of Revenue employees who perform substantial work as staff to the Board." The reasoning is to provide adequate compensation for key Department of Revenue staff so that the state does not lose them to the private sector. This harks back to the sixth whereas clause on the first page, where the Board is concerned that existing pay scales for professional staff are not competitive with compensation packages offered by private entities and other state agencies. This impacts the Board's ability to attract and retain key employees. Then an additional resolved clause could follow that the Board will work with the Legislature to ensure that the funding is available to fulfill the purpose of this resolution. The current resolution's fifth resolved clause regarding the Commissioner of Revenue working to implement the foregoing would be renumbered to six.

CHAIR PIHL requested that the whereas section be amended to reflect the ARM Board's charge to make sure that funding is there to meet benefits. He said that charge also includes maintaining investment performance, which to him means maintaining this investment team.

MS. HALL said that ARMB resolutions have been updated to read differently now, but she would make sure that this redrafted resolution reflects the Legislature's charge to the Board that the Chair was referring to.

MS. SCHUBERT <u>moved that the ARMB Salary Review Committee adopt Resolution 2007-XX with the changes and additions discussed, and forward it to the full Board with a recommendation for adoption</u>. COMMISSIONER GALVIN <u>seconded for purposes of discussion</u>.

On a roll call vote, Chair Pihl and Ms. Schubert voted yes. Commissioner Galvin abstained. The motion passed.

OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

MR. BADER suggested that at some point the Board should look at the compensation for the Investment Advisory Council (IAC), which has not been reviewed for several years.

MS. SCHUBERT asked Mr. Bader to do a review and bring a report back to the Board. MR. BADER agreed to do that.

PUBLIC/COMMITTEE MEMBER COMMENTS

MS. SCHUBERT thanked the Commissioner and Deputy Commissioner for agreeing to meet and talk about salaries and for being so open to Board input. She also wished Julie Pierce luck in her new endeavor.

ADJOURNMENT

The meeting adjourned at 12:40 p.m.