ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location of Meeting
Anchorage Marriott Hotel
820 West 7th Avenue
Anchorage, Alaska

MINUTES OF
November 29-30, 2005

Tuesday, November 29, 2005

I. CALL TO ORDER

CHAIR SCHUBERT called the meeting of the Alaska Retirement Management Board to order at 9:00 a.m.

II. ROLL CALL

ARM Board Members Present
Martin Pihl
Sam Trivette
Gayle Harbo
Gail Schubert
Larry Semmens
Bob Roses
Commissioner Scott Nordstrand
Mike Williams
Commissioner Bill Corbus

Consultants Present
Rob Johnson, Legal Counsel
Michael O'Leary, Callan Associates, Inc. CAI

IAC Members Present
Tim O'Brien
Bill Jennings
Jerrold Mitchell

Revenue Staff
Tom Boutin, Deputy Commissioner, Department of Revenue
Gary Bader, Chief Investment Officer
Susan Taylor, Comptroller, Treasury Division, Department of Revenue
Steve Sikes, State Investment Officer

Zach Hanna, State Investment Officer
Judy Hall, Liaison Officer, Department of Revenue

Department of Administration Staff
Kevin Brooks, Deputy Commissioner, Department of Administration
Melanie Millhorn, Director, Division of Retirement and Benefits, Department of Administration
Charlene Morrison, Chief Financial Officer, Division of Retirement and Benefits, Department Of Administration
Traci Carpenter, Division of Retirement and Benefits, Department of Administration

III. PUBLIC MEETING NOTICE

JUDY HALL confirmed that proper notice had been made of this meeting.

IV. APPROVAL OF AGENDA

MR. ROSES moved to approve the agenda. MS. HARBO seconded.

MR. TRIVETTE asked to add a discussion of KPMG's deferred prosecution as an agenda item.

There being no objection, the agenda was approved as amended.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

CHUCK BORG indicated he had spoken to the Alaska Retirement Management Board (ARMB) at its October meeting about health care and expressed the hope that the ARMB would be interested in how the earnings of the system are used, particularly in terms of health care expenditures. He was pleased that a Retiree Healthcare Cost Containment Committee has been established. He hoped that committee has some authority attached to it. He noted that anyone dealing with healthcare plans has to deal with access, cost, and quality. Cost typically becomes a focus because it is easy to understand and many times the approach to healthcare plans focuses on cost, causing the other two parts of the issue to suffer. He suggested that the title of the newly constituted committee communicate that quality of care and access to care will also be addressed. He felt a common sense approach that deals with a well planned and well executed healthcare initiative would address quality, access, and cost.

SARAH HORNBERGER, representing the Retired Public Employees of Alaska (RPEA) as chair of the State Medical Insurance Committee, explained she came to Alaska in 1963 as a principal and high school teacher, giving her a knowledge and history that younger people lack. She stated she has been a teacher and administrator in Bristol Bay Borough and Lake and Peninsula Borough, a member of the Lake and Peninsula School Board, and a district magistrate for the Alaska Court System. She has worked as an area historian for the National Park Service and has been a small business owner. As a result of these endeavors, she has accumulated a great deal of history about things in the state. Since retiring in 1971 she has been an active member and officer in RPEA. She stated she is concerned about many things, but focused on allowing the

ARMB to investigate and implement cost-saving measures in the state medical insurance program, such as disease management in diabetes, chronic heart disease, and obesity. Retirees are concerned with working with the state to maintain the trust fund, as evidenced in their cooperation in the successful use of generic drugs over brand name drugs. She suggested that the board investigate and implement other cost-savings measures that do not infringe on the earned rights of retirees. She asked that the prescription drug reimbursement from the federal government to the state and any reimbursement from Worldcom be returned to the retirement trust fund rather than some other state fund. She asked that the ARMB work to prevent any further diminishment of medical insurance benefits of Alaska's retired teachers and public employees than have already occurred between 1998 and 2000. She asked that this board work to undue the most egregious and harmful of those diminishments, such as the one that denies any state insurance reimbursement to a retiree who cannot find a doctor to file a Medicare claim.

VI. APPROVAL OF MINUTES

MS. HARBO moved to approve the minutes of October 11-12, 2005. MR. PIHL seconded.

MS. HARBO noted that references to "quarter method" on page 29 should be changed to state "corridor method."

There being no objection, the motion was unanimously approved.

VII. REPORTS

1. Chair Report

CHAIR SCHUBERT stated she has worked with staff to develop a proposed committee list. She emphasized that the list is a proposal only and if trustees desire changes they could contact her. The packet also includes a notice of a House Ways & Means Committee hearing scheduled for December 7, 2005. There is a proposal for her to testify telephonically at that hearing as chair of the ARM Board; remarks will be prepared by staff. She noted she has an AFN Board meeting that day, so her participation in the hearing would be abbreviated. CHAIR SCHUBERT noted that Mike Barnhill emailed a memorandum concerning ARMB authority. Mr. Barnhill will elaborate more on this memorandum during his report; this report was distributed to the Board.

2. CIO Report

GARY BADER stated at the first meeting of the ARMB the Board delegated authority to him to act on behalf of the board with respect to investment-related items. Part of that resolution required that he report if he has made further delegations. He notified the board that he has delegated certain authority for fixed income to Mr. Mitchell, Mr. Coltan, Mr. Bartlett, Mr. Djajalie, and Mr. Orr. With respect to alternative investments, real estate, private equity, absolute return, farmland and energy he has delegated authority to Mr. Mitchell, Mr. Hanna, Mr. Sikes and Mr. Cummins.

MR. BADER noted that the ASPIB authorized staff to make investments in REITs on behalf of the Board in order to begin a process of internal management of equity and to keep the real estate asset allocation in balance. At the end of December the real estate allocation is expected to be

9.7%, while the target is 9%. Additional allocations, authorized by the Board, will be made as opportunities arise. He asked that the allocation to REITs be reduced. Staff also recommended that the investment process be modified to allow a certain amount of staff discretion when a firm has done something that might not be considered a prudent investment simply because the process is to invest in the lowest market price versus net asset value. Staff also wants to reduce the tracking error in the portfolio, that is, how far it varies from the index. MR. BADER noted that the top 20 REIT stocks represent 50% of the index. Investing in the others presents the risk of being less index aware; staff asked that the Board authorize investment in a greater number of stocks in order to be more index aware.

MS. HARBO moved that the ARMB approve a $25 million reduction to the real estate allocation by liquidating a portion of the REIT portfolio and approve staff's suggested modification to the REIT portfolio strategy. MR. ROSES seconded.

There being no objection, the motion was unanimously approved.

MR. BADER advised trustees of the Callan Conference. Members who are attending should be aware that he has contacted RCM and Tukman Capital, two of the board's managers located in San Francisco. This would be a good opportunity for trustees to do due diligence with those managers. These managers also manage money for the Alaska Permanent Fund Corporation (APFC) so this offer will also be extended to APFC Trustees who will be attending the Conference.

3. Legal Report

MIKE BARNHILL reported on the question of the ARMB's authority to approve the Division of Retirement and Budget budget. He prepared a memorandum indicating the Department of Law concludes that the ARMB does not have authority to approve the budget of the Division of Retirement and Budget, but it can review and comment on that budget. This is consistent with a prior opinion by Mr. Johnson on this same question.

MR. SEMMENS remarked that the ARMB is responsible for managing the assets and a component of that management clearly is how the assets are spent. To him there is a disconnect between the ARMB's responsibility and authority, under this opinion. MR. BARNHILL responded that the statutory responsibility pertains to the investment of assets. If the Legislature had intended the ARMB be responsible for the budget, it would have been spelled out in the powers granted to the ARMB and that is not the case. In a governmental context, the Legislature has ultimate authority over expenditures. If a trustee has opinions as to how the Division of Retirement and Budget is expending its money, there is authority to express those opinions in the context of ARMB meetings and directly to the Legislature. Being a trustee in a governmental context is different than being a trustee in a private context in that the latter has authority over the budget. In order for the ARMB to have this power, the Legislature would have had to explicitly state that.

MR. BARNHILL indicated he wished to next discuss securities litigation. Most of this discussion can be done out of executive session. To the extent that additional detail is desired, an executive session may be necessary. He explained that historically the State of Alaska had no involvement and no understanding of securities litigation until 2002 in the wake of the collapse of Worldcom and Enron. At that point in time people began asking what the Department of Law was doing about the state's interests in pursuing securities fraud. As a result the state began to look at what it could and should do with respect to active participation on behalf of the state's investment funds in securities litigation. One of the first cases undertaken was on behalf of Department of Revenue, Division of Treasury and the ASPIB with respect to $26 million in losses the funds incurred in Worldcom bonds. A law firm that was recommending opting out of the class action suit and pursuing separate litigation in Alaska against the underwriters of the Worldcom bonds approached the predecessor to the ARMB. The ASPIB approved doing so, that litigation was filed in Juneau in April 2003, and it was moved to federal court and consolidated with the class action. That litigation ultimately settled about one month ago on terms that were advantageous to the state. Of the $26 million in bond losses, the state recovered $13 million. Just over $1 million was recovered on the investment funds stock. The litigation was controversial because the state's counsel had taken a strategy to have many funds opt out. This infuriated the judge who attempted many times to foil the counsel. MR. BARNHILL commented that outside counsel did an extraordinary job of getting a good recovery for the State. The APFC did not opt out of the Worldcom class action primarily because they did not purchase the kind of bonds the Division of Treasury and the pension funds purchased, therefore, their interests were completely covered in the class action whereas the Division and pension funds interests were not. Had the Division and pension funds stayed with the class action, $3 million of the $13 million would not have been recovered. There has been discussion in the media whether the class action litigants or those that opted out did better. The settlement money has been allocated back to the accounts.

COMMISSIONER CORBUS departed the meeting at 9:33 a.m.

MR. BARNHILL next discussed the AOL Time/Warner case, which the state pursued on behalf of all of the state's investment funds. That case is still pending in Juneau. The class action pending in New York settled several months ago. He understood settlement talks are underway for those investors that opted out of the class action. The intent of the State is to pursue this litigation aggressively. The estimate of APFC and pension fund bonds can be calculated in several ways, but the measure the state is using in its complaint is in excess of $70 million.

The final case the Department of Law is proposing to pursue and has obtained consent from the ASPIB and the APFC to pursue is against Quest. The initial estimate of damages on this case is similar to the AOL Time/Warner case at $70 million. In that case, the class action settled for $400 million and a penalty of $250 million. The state determined that its interests are protected by staying with the class action, rather than opting out.

MR. BARNHILL noted that the Department of Law reviews the approximately 200 class action cases that are filed annually to determine whether pursuing them is worthwhile. There is currently no additional lawsuit the Department of Law is interested in pursuing. Approximately one year ago a monitoring firm was hired to look at the state's losses in each case that is filed, which was posted on a website accessible by the state. That estimate of loss could be reviewed vis-à-vis the potential return on the suit, as well as a summary of the suit. MR. BARNHILL indicated he recently received authorization to initiate an RFP for a similar service. Hopefully over the next year there will be a systematic process for evaluating all the securities lawsuits filed in federal court. There are many law firms undertaking this work, all of which operate on a contingency basis, and all of those offer some kind of monitoring service without charge in the hopes that they will be hired to represent the state in securities litigation. It was his opinion that the state's interests are best served by keeping the plaintiffs' bar at a comfortable distance. There are times when the state can do business with the plaintiffs' bar to the state's benefit, but there are also times when such a relationship is not beneficial to the state.

4. Fund Financial Presentation

For more information on this presentation, refer to the document entitled "Alaska Retirement Management Board, Financial Report as of October 31, 2005" kept on file at the ARM Board offices.

SUSAN TAYLOR, State Comptroller, first presented summary information from July 1 through October 31, 2005, including beginning invested assets, change in asset value, net contributions/withdrawals, and ending invested assets for each of the pension funds and participant directed funds.

MS. TAYLOR reviewed a one-month summary of beginning invested assets, change in asset value, net contributions/withdrawals, and ending invested assets for each of the pension funds and participant directed funds for the month ended October 31, 2005. The total invested assets for the pension funds are $12.9 billion, the supplemental annuity plan assets are $1.95 billion, and the Deferred Compensation assets are $456 million. MS. TAYLOR noted that the funds by manager summary now includes all asset classes. She explained that the change in market value, the transfers in and out, and the ending invested assets tie to the summary she reviewed at the beginning of her presentation. She indicated she had distributed a summary of the Worldcom settlement. The pool participation was calculated when the losses were incurred and the settlement was distributed with that same allocation; interest earned was included in the total amount.

MR. SEMMENS commented favorably on the formatting of the financial reports.

BREAK 9:50 a.m. to 10:10 a.m.

5. Performance Review – 3rd Quarter

For more information on this presentation, refer to the document entitled "Alaska Retirement Management Board, Periods Ended September 30, 2005, Performance Review & Evaluation" kept on file at the ARM Board offices.

MICHAEL O'LEARY with Callan Associates Inc. (CAI) explained the report he was presenting is preliminary because real estate data was not available at the time of its preparation. Townsend provides real estate figures to CAI; they have until late November to prepare their report and this report had to be mailed mid-November. CAI used index return for the direct real estate portion of the portfolio. When the finalized numbers are received, CAI will recompute all the numbers and provide a final report for the quarter. This situation occurs approximately once annually.

MR. O'LEARY reviewed a graphic representation of the Treasury yield curve at the end of the 3rd quarter 2004, beginning 3rd quarter 2005, and ending 3rd quarter 2005. This comparison shows that the yield curve has flattened with the biggest change in the 3-year and less range. During the September quarter rates went up across the entire yield curve and bonds lost money.

MR. O'LEARY next reviewed the effective yield of various credit qualities relative to Treasurys. High quality bonds yielded very little more than Treasurys, while the Lehman Brothers High Yield Index has the greatest spread over Treasurys; this is expected because the anticipated default rate among high yield bonds is greater. During the last quarter, the spread narrowed between high yield bonds and Treasurys, primarily because Treasurys increased in yield.

Reviewing the performance of the broad stock market as measured by the Russell 3000 compared to the Lehman Brothers Aggregate Bond Index, MR. O'LEARY noted that for the last three quarters the bond market return has been only 1.8%, while the stock market return was 4.0%. For the last three years, the equity return is 18.1% compared to 4.0% for bonds. The five-year figure captures the majority of the bear market, with stocks returning (0.7)% and bonds returning 6.6%. The 10-year returns are more consistent in terms of strategic long-term returns at 9.5% stocks and 6.5% bonds. However, it would be unrealistic to expect bonds to produce a return of 6.5% in the next 10 years, given interest rates today. The approximately 3.0% spread between bonds and equities returns is typical for most longer run periods.

A review of rolling 1-year returns for bond and stock markets dramatically illustrates the strength of the equity market recovery for the last three years. For the last quarter, domestic stocks as measured by the Russell 3000 returned 4.0% compared with international stocks as measured by the MSCI EAFE Index returning 10.4%. That difference explains the difference for the last three quarters and for the trailing 12 months. Over the 5-year period, international stocks have had a positive return while domestic stocks had a negative return. Over the last 10 years domestic stocks have out performed international stocks, largely because of currency; in the first five years the dollar was relatively strong, although in the last five years the dollar has been relatively weak.

MR. O'LEARY next reviewed large cap versus small cap stocks. During the quarter small cap measured by the Russell 2000 did better than large cap as measured by the Russell 1000. Year to date, large cap has done slightly better than small cap. Over the 10-year period returns for large and small are close. Reviewing large versus small in terms of rolling 1-year returns, small cap has done better than large cap companies for the last six years. Very recently, that has changed.

Using the Russell 3000 Growth Index and Russell 3000 Value Index as measures, growth slightly out performed value in the last quarter, but under performed for the last three quarters, 1-year, 3-year, 5-year, and 10-year periods. MR. BADER asked for an explanation of value and growth for benefit of the Board. MR. O'LEARY explained that Russell and other index provider use statistics that are measures of value, such as price to book, price to sales, price to earnings, dividend yield, etc. They array companies from the most to the least expensive and take those that are apparently the least expensive and consider those value. Other statistics like expected earnings growth, recent earnings growth, year-over-year change in earnings, and revenue growth are used to determine growth-oriented companies. Each index provider does this slightly differently; CAI finds Russell's approach valuable. Any time there is reliance on collective analysts' forecasts for future expected growth, there is a question whether it is a reasonable expectation of the future or more a function of which stocks have been doing well recently. Russell reconstitutes its indexes annually and they are capitalization weighted, meaning companies with higher market value count more heavily in the index formulation than smaller companies. The Russell 2000 smallest companies account for 10% of the Russell 3000 Index.

MR. O'LEARY explained that 1-year rolling returns from September to September show a greater disparity between growth and value. In the last 5+ years value has done so well relative to growth that the dispersion of valuation measures has been compressed. Today many feel that some of the largest, highest quality, most profitable companies with decent earnings outlook are priced relatively inexpensively compared with the average company. This disparity could be addressed by the average company stock declining in value, creating a spread, rather than these stocks rising in value.

MR. O'LEARY next reviewed the asset allocation for PERS as of the end of the September 30, 2005 quarter relative to the target asset allocations set for every asset category. Some assets are difficult to invest in, so there may be a larger disparity between the target and the actual allocation. If an asset category is over target, another will be under target. If an asset type that is over or under target is liquid, it is easy to rebalance. If they are not highly liquid securities, it is very difficult to rebalance.

MR. SEMMENS asked what impact the deviation from target has on expected risk or expected return. MR. O'LEARY explained the ranges around the targets were set with the idea of maintaining the risk return level in mind. If the winners were allowed to run for a protracted period, the risk/return structure would be altered. For example, in the late 1990s if the hot growth companies became a larger part of the portfolio, the equity allocation would have been significantly over target at the start of the bear market in the equities that were the most over-valued. There is a question how to address the situation of the boundaries of a range being pushed. The fund does not typically go outside the ranges because there are cash flows that must be funded from someplace and typically they are funded over time from the over allocated assets.

MR. O'LEARY next reviewed the asset allocation of the pension funds (Fund) versus other public funds as represented by 80% of the CAI public pension fund database, excluding the top 10% and bottom 10%. This analysis depicts the target and the median allocation of public funds as of the end of the quarter. In comparison with other public funds, the Fund is very broadly diversified with exposure to the "alternative" category, explicit rather than opportunistic exposure to international bonds, higher than median international equity exposure, comparatively high real estate exposure, and comparatively low bond exposure. The Fund's allocations have developed through time and were most explicitly adopted within the last two years. The allocation to "alternative" includes private equity, absolute return and other, which includes agriculture and three fund-of-fund investments. Investment in private equity was begun some time ago but it takes time to invest and as of now one manager has meaningful returns.

MR. O'LEARY next reviewed results for the September quarter. He noted that during the September quarter included Hurricane Katrina, oil and gas prices skyrocketed, and interest rates went up. It was difficult to perform during that period without a lot of energy exposure. The return of 4.13% for PERS for the quarter looks attractive both absolutely and relative to the target index. Managers, on balance, added value during the quarter. Theoretically he would be pleased if there were 0% asset allocation effect because that would mean the Fund was invested precisely at its target levels throughout the quarter. Realistically, when there are multiple asset classes, including illiquid asset classes, this cannot be expected. If there is a variance, it is best to be positive, and in this quarter both PERS and TRS had a 0.12% asset allocation effect as a result of over funding in stocks and under funding in bonds.

For the trailing 12 months, PERS and TRS enjoyed good returns at 13.33% and 13.40%, respectively, mostly driven by a strong 4th quarter in 2004. On balance, during both the quarter and the 1-year periods there was positive manager effect and positive asset allocation effect. Over the 5-year period, which includes the bear market, Treasury yields were better than domestic stocks, domestic fixed income out performed Treasury bills, and international equity was superior to domestic equity. Relative to its peers, the Fund has had competitive international returns, superior bond returns, and under performing domestic equity returns over the 5-year period.

At the total fund level, for the 14-year period, PERS has had performance of 8.84% and TRS has had performance of 8.91%. This information is helpful in considering what is a reasonable policy target.

MR. SEMMENS noted that over the 14 years there has been a 5 basis point manager effect and he had asked at the October meeting if is it fair to ask that this be quantified and compared against cost of the managers; the answer was that it is fair. He asked whether that data would be provided. MR. O'LEARY stated that he and Mr. Bader have discussed this and there is a plan to at least annually prepare a net of fee return figure and present that to the Board.

MR. O'LEARY next reviewed the cumulative total Fund return for the quarter, 1-year, 2-year, 3-year, and 5-year periods. The Fund was at median for all but the 5-year and slightly below target except for the 1-year period. Those funds that have had strong returns over the 3-year period have had a much greater equity allocation. Those who have had the strongest performance over the 5-year period had a greater bond allocation.

MR. O'LEARY reviewed calendar period performance for the 9 months of 2005, noting that performance for PERS and TRS is greater than the target index at 5.35% and 5.39%, respectively compared to 4.73% for the index. Total domestic equity for the quarter was up 3.63% and the S&P500 was up 3.60%. Over the 5-year period the total domestic equity out performed the S&P500. The large cap component, which is significantly invested in the S&P 500, returned 11.36% versus the S&P500 at 12.25%. The small cap component was up 14.51%, but its relative performance was poor compared to the Russell 2000 at 17.95%. During the last quarter small cap has been 4.99% compared to 4.69% for the Russell 2000. During the fourth quarter a small cap manager was terminated, the money was put in an index fund pending selection of additional managers, those managers were selected early in the calendar year and funded in the second quarter. This is the first quarter that the impact of that change is seen. Small cap performance on a calendar year basis shows returns during 1997, 1998, and 1999 above benchmark, for 2000, 2001, and 2002 below benchmark, strong recovery in 2003, and poor performance in 2004. There was a growth bias in the portfolio at the beginning of the bear market that explained the under performance of the portfolio in that market; the initial corrective steps were not sufficient, but hopefully they are now.

Total international equity performance relative to other public funds has been quite strong and above the EAFE Index and MSCI ACW ex US Free. A comparison of the Fund international ex emerging markets compared to CAI's Non-US Equity Style Group shows performance has generally been above benchmark and generally competitive.

For the 5-year period, total domestic fixed income has performed in the 90th percentile at 6.17%, while the 10th percentile is 7.21%; the spread is narrow, which is characteristic of bonds. The Fund return has been very competitive and superior to the benchmark; a large percentage of these funds are managed internally. MR. PIHL asked if these figures are net of cost. MR. O'LEARY stated the cost of internal management is 2 to 3 basis points. The in-house portfolio is being compared against a pre-fee database. There are many large public funds that also manage at least a portion of fixed-income internally. There is a narrow return spread between the in-house and externally managed portfolios, while the latter has greater fees. MR. O'LEARY stated he is comfortable that large funds have a significant portion of bond funds managed internally, so long as there is a capable staff.

MR. SEMMENS asked whether there are members in CAI's database of peers that are consistently in the top quartile, noting that the Fund appears to be close to median. MR. O'LEARY stated by definition 25% of the funds in the database are in the top quartile over the 10 years, but the question is how much they have ranged on a shorter-term basis yet still managed to achieve that standing in the long-term. There are funds that have had as many good years and bad years as this Fund, but have done better overall. Those funds have tended to be more broadly diversified and very consistent in their policy. Looking at the PERS return and the APFC return, there are many of the same managers and other similarities, but the biggest difference is the longer term real estate investment; the APFC has had a 10% target to real estate for a very long period of time, which helped performance. The Fund's domestic manager structure is problematic only in terms of omission; that is, the Fund has not had a true balance between growth and value. Some funds attempt to chase the policies of funds that have been in the top quartile for the last 3 or 4 years and they frequently end up in the bottom quartile. MR. O'LEARY stated the Fund's policies should reflect its needs. This system's asset allocation will have to change over time and any relative comparison will become much less meaningful.

MR. O'BRIEN noted in terms of comparison to median that if every year the Fund were right at median, whether the total portfolio or a component of the portfolio, the 10-year figure would put the Fund in the top quartile, not the top decile. MR. O'LEARY felt that performance relative to the target index is an appropriate comparison. If the target index chosen by the Fund is different than the index chosen by others, there should be discussion. Once satisfied with the index being used, the only question remaining would be why the Fund is not doing as well as the target index.

MR. O'LEARY reviewed individual manager returns. BlackRock, one of the Fund's external fixed income mangers, has performed well over the longer term compared to the core style group, which is the group to which the in-house portfolio was compared. BlackRock is one of the premier bond managers in the world. Mondrian International manages an international bond portfolio for the Fund. This portfolio is primarily invested in non-dollar denominated bonds. The currency volatility of this portfolio is more than twice the volatility of the US bond market. This manager can hedge, if they wish, but their benchmark is non-dollar denominated. The Fund has two new bond managers, McKay Shields and ING, both of which manage high yield bonds. The expectation is they will earn more than investment grade bonds, but with significantly more volatility. Both McKay Shields and ING did better than the benchmark for the recent quarter.

MR. O'LEARY next reviewed the performance of the Fund's large cap managers. Capital Guardian has managed a value portfolio for 10.5 years and has produced a 12.8% return annualized over that period, which is over 200 basis points above the S&P 500. Last year, they out performed the S&P 500, but returned below median. For the longer periods their returns are attractive. McKinley Capital has managed a domestic equity portfolio for 8.5 years; this manager had excellent quarter up 6.04% versus the Russell 1000 at 3.95% and the S&P 500 up 3.60%. They are up 14.95% for the last year. RCM has managed a large cap portfolio for 10.25 years. Since inception they have returned 11.36% versus the S&P 500 at 10.06%. Over the 5-year period they under performed the benchmark, but they were at the top quartile among large cap growth managers in that period. They did better in the trailing 12 months; they have not as volatile or as strong recent results as McKinley, which is consistent with expectations. Relational is a new large cap manager that is an investment in a partnership. Their returns were slightly below the index for the last quarter. They believe the companies in which they invest have a key opportunity to enhance value and they invest to influence management's actions. State Street manages an index fund for the Fund. MR. O'LEARY noted that for a meaningful cumulative period, the median core manager has generated a greater return than the S&P 500; five years ago, the S&P 500 would have been top quartile. This, in part, reflects the valuation difference to which Mr. O'Leary referred earlier. Tukman has managed for the Fund for 5.5 years and has had a 4.43% difference in return relative to the S&P 500 since inception; they protected well during the bear market years. This manager experienced a loss in the last 12 months. MR. O'LEARY stated he visited Tukman on-site in mid-October; there are only two key professionals at this firm and a very small staff. MR. O'LEARY stated this manager has a true long-term focus on companies. This manager manages $9 billion with only two key investment professionals. They manage $4 billion for one of the Vanguard Windsor funds. While on his site visit he learned that they individually do not invest in individual stocks, but rather they invest in index funds. This is the case because the only stocks in which they would invest are held in client portfolios and they were concerned with a perception of a conflict of interest. They have lost some business, much of which they had gained in the last three years. They have also gained some business in the last three years.

Reviewing small cap managers, MR. O'LEARY explained that the Fund has a small position in a Russell 2000 Index Fund. TCW has managed on behalf of the Fund for 3.5 years and has not done well during that time period. They made a significant commitment to growth stocks and sectors expecting economic recovery with an emphasis on business investment; this has yet to be realized. They are concentrated in information technology. This is a high quality organization.

Turner manages a small cap blend product for the Fund. They were offered more money and declined. They have managed for 1.5 years and have achieved an 11.77% annualized return. Their portfolio characteristics are consistent with their style. Jennison, Lord Abbott, and Luther King, the three new small cap managers, now have one full quarter of returns. Their performance has been better than the benchmark and two of the three have had extraordinary performance relative to their peers.

Reviewing international equities, MR. O'LEARY stated Brandes has managed for 8 years and has had an extraordinary return of 13.38%relative to the benchmark at 4.72%. In the recent 12 months their return was slightly below the benchmark. Capital Guardian has managed an international portfolio for 4 years. This portfolio has a slight growth bias. They were having a performance problem, but now since inception performance is marginally above benchmark and in the last year performance has improved nicely. There are two new international managers, McKinley and State Street Global Advisors. The latter is performing at the index and McKinley, which has a growth orientation, is up 15% versus 10.4% for the index. Lazard has managed a global portfolio for 12.25 years and has beaten the benchmark by over 1% over that period; the 5-year return exceeds the benchmark by over 2%; but the shorter-term numbers are below the benchmark. This manager is discussing increased flexibility with staff.

MR. O'LEARY reviewed cumulative and quarterly relative returns for Lazard versus the benchmark and the global manager average. Through mid-1998 Lazard's cumulative performance was attractive relative to the MSCI World Index, they lagged in 1998 and 1999 and the first part of 2000, followed by strong out performance through the end of March 2003, trailing off slightly since that time.

Capital Guardian's emerging markets portfolio had tremendous cumulative performance, after fees, through the market peak and trailing off since then. The absolute figures for this manager are 45.17% for the last year versus the MSCI Emerging Markets Index at 47.18%. This manager has a small bond position and some cash in this fund, which constituted a big drag on performance. Their relative performance needs improvement. There are signs of improvement, but that is not reflected in these figures. For the three quarters of 2005, Capital Guardian is ahead of the index. J.P. Morgan's emerging markets fund was up 44.64% for the year versus 47.18% for the index. During the late 1990s their cumulative performance was not as great as Lazard.

The internal REIT portfolio has not performed well relative to the CAI REIT database for the quarter and has under performed the index for the three quarters of the year. MR. O'LEARY stated he is comforted by the staff recommendation and the ARMB approval of the portfolio becoming more benchmark aware and more broadly diversified, which should address the situation of outliers in the portfolio.

Mariner, Cadogan, and Crestline manage the three hedge fund-of-funds. Mariner and Crestline have had competitive returns for the three-quarter year-to-date period for which data is available, while Cadogan was below the benchmark. MR. HANNA noted that Cadogan has a different benchmark; their returns are actually stronger than the other two . MR. O'LEARY explained that Mariner and Crestline are compared to the absolute return hedge fund-of-funds group, while

Cadogan is compared to a long-short hedge fund style group. MR. HANNA indicated that Cadogan generally has had much lower volatility than the long-short universe.

MR. O'LEARY stated the SBS and Deferred Compensation portfolios have performed in line with expectations. The balanced portfolios outpaced their targets for the quarter and trailing 12 months. The target maturity funds enjoyed a good quarter, raising the trailing 12-month return to benchmark levels. The SSgA funds are on track. The underlying fund T. Rowe Price uses to build the target maturity funds also did well. The active funds, other than Brandes and BGI TAA, outpaced their targets for the quarter and trailing 12 months. Brandes out performed for the quarter, lagged slightly for the year, and has excellent longer-term results. BGI TAA outperformed for the quarter, lagged for the year, and has mixed results for longer periods. The new stable value option is working as expected. The BGI TAA fund is comprised 60% S&P 500 and 40% long Treasurys. For the 5-year period they under performed the benchmark, but for the 3-year period they are above it. Brandes has had good returns, with slight under performance relative to the target for the last quarter. Capital Guardian global balanced portfolio had a good quarter, a good year, and returns have been above benchmark for the 2-year and 3-year periods. Citizens had a good quarter. T. Rowe Price small cap trust did well. Stable value did well. The Balanced Fund and Long-Term Balanced Fund are both doing well over the quarter and year.

MR. O'LEARY noted that the Deferred Compensation asset allocation was contained in the written presentation.

LUNCH BREAK 11:30 a.m. to 1:17 p.m.

6. External Manager Review

GARY BADER noted that trustees received copies of questionnaires that were sent to each manager of the Fund. Each year the IAC, CIO and Mr. O'Leary review these questionnaires and discuss the portfolio and its characteristics. He asked that the IAC offer any comments they have on the portfolio following Mr. O'Leary's presentation.

MR. O'LEARY explained that his presentation would explain the composition of the aggregate domestic portfolio. The growth and value composition of the portfolio is affected by the growth or value tilt of managers. The allocation within small and large cap is affected also by the capitalization size of companies within each category. Active managers are not consistently within one narrowly defined area and have bets that can affect the composition of the portfolio.

To aggregate underlying portfolios Morgan Stanley Capital International (MSCI) has developed Z-scores, which CAI purchases. Z-scores are calculated as growth, value, and composite scores. The growth Z-score is an aggregation of five fundamentals: long-term forward earnings growth, short-term forward earnings growth, current internal growth, long-term historical earnings growth, and long-term historical sales growth. The scores range between -3 and +3. The value Z-score is measured based on price/book, price/forward earnings, and dividend yield with scores again ranging -3 to+3. The closer to zero, the more core-like or market-like is a portfolio.

MR. O'LEARY first reviewed the growth Z-score for the entire domestic equity pool and large cap core versus the Russell 3000. The value Z-score is expected to be positive and that score is subtracted from the growth score to get the combined score. The Fund's domestic equity pool has had a growth bias.

The aggregate large cap pool combined Z-score against the baseline of the Russell 1000 reveals a stable growth tilt. This is largely the result of a negative value Z-score, or under weighting toward value factors. Compared to the S&P500, the large cap pool has a positive growth Z-score and a negative value Z-score.

State Street had a large negative combined Z-score growth compared to the Russell 1000 in 2005. Capital Guardian had a positive value Z-score early in 2000 and has had a growth tilt because of the negative value Z-score, resulting in something of a growth bias in recent years. However, in 2000 the combined Z-score was not growth biased. The domestic component of Lazard's global portfolio has had a negative growth Z-score and a slightly positive value Z-score; they are core with a value tilt. In managing a global portfolio it might be possible for a manager to invest in a particular sector but for all of the holdings in that sector to be in a particular country. Therefore, it is a disservice to review such managers using a silo approach, but because Lazard is part of the Fund's aggregate domestic equity pool, that must be done in this case. McKinley has had a positive growth Z-score and a negative value Z-score and a very consistent growth tilt relative to the Russell 1000; this is consistent with expectations. RCM looks the same. Tukman had a negative growth Z-score in 2000 and a high positive value Z-score due to the extraordinary misvaluations between growth and value.

DR. MITCHELL noted that Tukman could have held one stock in 2000 that was classified as a value stock and that was classified in 2005 as a growth stock. The financials of the holdings changed, but the holdings themselves did not change. MR. O'LEARY added that the composition of the style indices changed. Tukman's combined Z-score is insignificant, hence they can be called a core oriented manager. None of the large cap managers have a pronounced growth bias. MR. PIHL noted that there should have been a pronounced growth bias in recent years. MR. O'LEARY explained CAI counsels clients to structure like the broad market, unless there is a reason to be very different. Many academics have argued that having a value orientation is a potential source of active returns. There is also evidence that suggest smaller companies will do better than large companies over the long-run. From a policy perspective, the ARMB has to become comfortable with having any bets in terms of growth or value and, if so, what should those be. Currently, the Fund has a bias against value and toward small cap.

CHAIR SCHUBERT asked if the growth tilt happened when Ark Asset Management was terminated. MR. O'LEARY replied in the affirmative. He expanded that the primary value oriented manager was Ark and they were terminated. Among the finalists to take that mandate were Wellington, Dodge & Cox, and Tukman; Tukman was selected.

The combined Z-score for the Fund's small cap pool had a growth bias in 2002 and has a minor growth bias currently. Jennison, for which there is only one quarter of data, shows a slight growth bias. Lord Abbott has a similar pattern, but there is insufficient data. Luther King has a slight growth bias. TCW has tended to not have a high growth Z-score, but has not had a high positive value Z-score; the combination has been close to neutral. Turner has some growth bias, but there is limited history for that manager.

MR. O'LEARY indicated that when he, Mr. Bader, and the IAC members met, they discussed whether the current portfolio structure should be altered. None of the managers are behaving other than expected, but there does appear to be a void. Small cap versus large cap allocation is a discussion at a different level, but something the Board will be asked to specifically address in the future.

A member of the audience asked why mid-cap stocks are not included in this analysis, noting that they do well. MR. O'LEARY explained the Russell 3000 covers mega-cap to very small cap companies so mid-caps are either in the lower end of the Russell 1000 or the upper end of the Russell 2000, so they are embedded in the Russell 3000.

MR. BADER remarked that former IAC member Dr. Haugen was a strong value advocate; he encouraged the ASPIB to have a tilt toward value investing. The ASPIB had a conscious bias to value at a time when value was in vogue; that bias was represented largely by Ark. Ark was attempting to be a value manager by holding large amounts of cash during a very strong market. The ASPIB eventually terminated Ark. In part as a result of this experience, the ASPIB adopted a policy that no manager will hold over 3% cash without approval of the CIO. There was concern with paying investment management fees on cash. Tukman was hired to replace Ark and the investment with Tukman has been successful. The Fund's portfolio does reflect a growth bias, although he did not believe the ASPIB made a conscious decision to have that growth bias, but rather it evolved out of not wanting to have a deep value manager like Ark.

MR. JENNINGS stated that academics currently see three main sources of additional return: small cap bias, value, and something likened to McKinley's strategy in the growth space. The current valuation of growth stocks relative to value stocks is attractive. While there might be a long-term bias toward value small cap momentum, the IAC did not see urgency to return to a 50/50 growth/value composition. If there are bets, they should be made consciously and comfortable for the ARMB. The Fund has some managers that will deviate widely from benchmarks, such as Tukman and Relational and the Fund must have high conviction about those managers, as well as their style.

MR. O'BRIEN felt the starting point for the ARMB should be to structure like the market and then decide which way to lean. He favored small cap, explaining that conceptually a large company is watched by many Wall Street analysts and it is not possible for one set of analysts to do a better job watching that company than another. Small cap companies are not watched as closely by analysts and those that will grow into the large cap companies can be exploited by money managers. Value is essentially "buying on sale" because value stocks have prices that are discounted from earnings.

DR. MITCHELL agreed with Mr. O'Leary's observation regarding the helpfulness of Z-scores. He also agreed with the observation that the ARMB should take a neutral to market position in terms of growth/value and large/small cap, then deciding whether to vary from that position. He noted that consideration must also be given to the quality of managers; the ARMB has high quality managers and they will perform in large measure as they have represented. If the Fund wants returns that are above median, there would need to be another discussion.

7. Lazard Freres Asset Management

For more information on this presentation, please refer to the document entitled "Alaska Retirement Management Board" dated November 29, 2005 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, JOHN REINSBERG and TONY DOTE presented to the Board. MR. DOTE stated Lazard is a value manager that is global in nature with offices and research analysts and clients around the world. The global portfolio has been managed for the State of Alaska since inception. The firm has $76 billion under management with two-thirds of assets in global and international. Lazard had been a private company since 1848 and in May 5, 2005 the public was taken public. Nothing has changed from an operational point of view. MR. REINSBERG noted that the employees of the asset management business own 23.4% of the company. MR. DOTE stated Lazard operates two main businesses: investment banking and financial management. Lazard Asset Management looks for companies that are financially productive, using return-on-equity as a measure, and that are earning more than their competitors. Lazard looks at the valuation of a company before investing, investing in those with relative value. Deep value managers will buy companies that are cheap from a valuation standpoint, but Lazard looks at relative value using price to cash flow, P/E ratio, and price-to-book.

MR. DOTE explained Lazard's investment process, which involves analytical framework/ database screening, accounting validation, fundamental analysis, and recommendations from the team that lead to portfolio construction. Superior returns to the index at lower risk levels than the index is the aim. Lazard tends to out perform the market and its competition during flat and falling markets.

MR. REINSBERG briefly reviewed the key members of the global equity team, noting that most of the members have a significant history of working together. Two initiatives have been undertaken in the last six months: adding a senior managing director to the team (Michael Fry) and enhancing geographical resources by adding a team of investment professionals in Japan. MR. REINSBERG noted that for most of the relationship with the State, Lazard has not found value in Japan; that has changed in the last 9 months.

MR. REINSBERG reviewed the streamlined senior management group outlined on page 4 of the presentation. There are global teams of analysts organized by sector, not by geography. Individuals from industry have been recruited, in addition to financial professionals. He gave several examples of team members who have come from an industry background.

MR. DOTE reviewed the firm's market performance year-to-date through September 30, 2005. Foreign markets continue to out perform the US market. There is an over weighting in the global portfolio to foreign markets. Returns in Europe have been competitive up 7.3%, while the US has been up 2.8%. Japan was up 12.2% through September. Lazard increased its position in Japan and that has benefited the portfolio. The dollar has been strong, which has affected the portfolio.

MR. O'LEARY noted that Lazard has the flexibility to hedge defensively, if it chooses. MR. DOTE stated there are periodic decisions to put on hedges. MR. REINSBERG noted that this last happened in 1994.

MR. DOTE reviewed the market environment from 2003 through the 3rd quarter 2005, during which time energy stocks have out performed, along with cyclical stocks (industrials, materials and process), interest sensitive stocks (finance and utilities), small cap stocks, and emerging markets equity stocks. Since mid-June 2005 the rally in Japan was led by financials. Beginning in the 4th quarter 2005 the market is experiencing a style shift with core to growth outperforming deep value, healthcare and consumer stocks outperforming, and large cap stocks performing in line with small cap stocks. Emerging market countries continue to out perform.

DR. JENNINGS asked what the board should expect to be normal exposure to small cap and emerging markets, noting there was authorization in the last year to take small cap and emerging markets positions up to 20%. MR. DOTE agreed that the maximum is 20% each in emerging markets and small cap. The exposure to emerging markets is 18% and he expected that exposure to remain. Small cap is 10%, coming down from 20% approximately one year ago.

MR. O'LEARY asked for a discussion of why there was not previous exposure to emerging markets and small cap. MR. DOTE explained that Lazard has been recommending the use of small cap and emerging markets for some time. The issue is the mechanism Lazard used to implement, which is an institutional mutual fund. Lazard uses mutual funds because it facilitates the ability to meet or trim exposure to small cap within emerging markets and because it is a diversified portfolio. MR. O'LEARY noted that when a trustee looks at the Lazard portfolio they will see individual stocks, but those will tend to be large cap and in developed markets. There will then be line items for two institutional mutual funds. He asked how there is protection so that the Fund is not paying fees twice. MR. DOTE explained that Lazard rebates the amount of the fee being charged against the mutual fund so that the fee to the State is neutral in terms of that mutual fund. MR. O'LEARY remarked that if this were not done, Lazard would be in a conflicted position because an increase in allocation to either area would result in higher fees.

MR. DOTE stated the firm has been running 2 to 3 points ahead of the index over the last five years. Over the 12+ year period the firm has out performed the index by 2%. The portfolio is up 2.1% versus 1.8% for the index in the recent quarter. Year-to-date through November 25, 2005 the portfolio is up 7.5% versus 8.1% for the index. The allocation to international is over weight and to US markets is underweight. The allocation to small cap is 10.3% and to emerging markets is 16.2%.

The portfolio out performed the index and other global managers for 1994 through 1998, during a time when the markets were driven by proven fundamentals; this environment is returning. Because of Lazard's style, 1999 was a difficult environment. The firm experienced out performance relative to the benchmarks in 2000, 2001 and 2002, which were down markets. A difficult environment existed for Lazard's style in 2003, 2004, and 2005. Lazard expects to out perform the index and managers in the coming years as the market rotates.

MR. REINSBERG stated large cap stocks are becoming more attractive. Small cap stocks in Europe were at a 38% discount in 2000 and are now at a 44% premium. Companies with higher return profiles are beginning to rebound; those tend to be larger cap companies. Third, historically expensive sectors are trading at attractive valuations and historically cheap (value) sectors are becoming expensive. The portfolio changes include over weight energy and consumer sectors, under weight utilities and industrials, and increased exposure to Japan. MR. REINSBERG explained that Japanese equities P/E ratio was at one point 70X earnings, but it is now coming in line with the rest of the world. Return on equity is rising dramatically in Japan. Financial stocks have led the recovery. Lazard out performed Japanese equities through its stock selection during the period when stocks were up 20%. Lazard achieved this by buying Mitsubishi Tokyo group, Sumitomo Trust, Nomura, and Toyota. Toyota, a bank that produces vehicles, today has the leading position in hybrid technology. Sony was also purchased. Approximately one year ago the board of Sony brought in a non-Japanese head, Howard Stringer, who was former chairman of CBS. Mr. Stringer lives in New York and London and runs one of the largest companies in Japan.

MR. REINSBERG noted that companies with valuations of $20 billion and above dominate the portfolio; these companies have higher valuations. Discussing the attributes of sectors, he noted that utilities are expensive to where they have been over time, so Lazard has a low exposure to utilities. Metals have also gotten expensive. Telecommunication companies are cheap, as are energy stocks.

MR. REINSBERG quickly reviewed the holdings in the Fund’s portfolio. The largest bets in the portfolio are in consumer, energy, and utilities. On a country basis, the most significant bets in the portfolio are France, Japan, and the US. He explained that the country allocation is a residual to bottom-up stock selection. The global investment environment is again in a transitional mode. Money is not as cheap, which ought to have a direct impact on better capitalized companies with strong balance sheets and strong free cash flow. Companies with strong fundamentals will continue to be rewarded, particularly in Japan. Larger cap companies with high returns and low valuation are being driven by fundamentals. Emerging markets, while up 30%, continue to offer an attractive opportunity set.

MR. SEMMENS noted that Lazard has returned 2% over the index since inception. He asked what that return would be less fees. MR. DOTE estimated that fees have averaged 30 basis points, so the net would be 1.7% to 1.75%. MR. REINSBERG noted that the portfolio has experienced an expected pattern of returns, one that protects in falling markets and participates in rising markets. Particularly over the last two years that has been driven by lower quality stocks, this has been the case.

COMMISSIONER CORBUS arrived at 2:20 p.m.

DR. MITCHELL asked how Lazard determines that a new company manager, for example in the case of Sony, is not just a name and a last attempt for a company that has not been able to make money from its products. MR. REINSBERG replied that before investing in Sony, Lazard met with Howard Stringer. Lazard visited Sony in December and their write-ups said it was the worst company meeting ever. Mr. Stringer has an agenda and he suggested that, rather than making grand projections, he should just be watched. If a manager is going to do things that have not been culturally accepted, such as selling off pieces of the company or moving production offshore, it is difficult to predict what will happen. Lazard knew Mr. Stringer from CBS, which was important.

MR. PIHL believed there were no legal issues related to Lazard, but asked whether there were currently any pending legal matters. MR. REINSBERG replied there was an audit by the SEC a couple of months ago, which is an ongoing practice, and Lazard is waiting to hear the outcome of that. There are no pending legal issues. MR. DOTE added that before compliance became the issue de jour, it was always a strong part of Lazard's culture. MR. REINSBERG stated Lazard has a compliance officer for asset management around the world.

CHAIR SCHUBERT was surprised with the over weight in France, given the steady unemployment rate of 10%. She noted that youth, and more recently the minority population, has been feeling disenfranchised. MR. REINSBERG explained the individual securities in France include only two companies that are totally French. He reviewed several of the holdings individually. The question is what is happening in individual companies, rather than in France. The uprisings in France of late have had no effect on the companies in this portfolio.

8. Trust Company of the West

For more information on this presentation, please refer to the document entitled "TCW Value Added and TCW Energy Fund X Presentation to Alaska Retirement Management Board" dated November 29, 2005 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, NICK GALLUCCIO, STEPHEN McDONALD and BLAIR THOMAS presented to the Board. MR. McDONALD reviewed the backgrounds of Mr. McDonald and Mr. Thomas. He stated the firm started in 1971 in Los Angeles and currently manages $120 billion in several strategies. Four years ago 50% of TCW was sold to a French bank, which has gone well. There was a change in management this year, putting into place what had been the management for the last three to four years. The firm has had good growth over the last 30 years. Assets are comprised of $52 billion in equities, $54 in US fixed income, and $7.5 in alternative. There are 14 discrete investment groups within TCW. The firm has been doing value added for this Fund since March 2002; it has a long-term consistent excellent record, but there have been difficulties over the last 12 to 13 months. This portfolio began roughly and then came on strongly. For the last month the portfolio is up 8.3%.

TCW Value Added

MR. GALLUCCIO stated he is the manager of the TCW Value Added portfolio, which is a small cap diversified portfolio. He has been at TCW for 24 years and his partner has been with him for 21 years. There are six analysts supporting this product. TCW is a value manager, not a market timer, so there are dry periods. This style of investing looks to buy good companies at good prices and to make money for its clients over time. The firm is a domestic diversified value manager with 185 stocks in this portfolio. The firm subscribes to the Graham & Dodd philosophy of investing and tries to buy companies at a discount to their intrinsic value of the assets or the future earnings of the business. The basic question is if it is a good business and will it be a better business in five years. The question is when the stock market will realize that the portfolio should not be as cheap as it is. He could not answer this because it takes time. The firm's style of investing has remained the same for over a decade; they are contrarian investors. MR. GALLUCCIO noted that market timing and value investing are diametrically opposed.

MR. GALLUCCIO noted that the portfolio was hit hard when Hurricane Katrina hit because of over weighting in technology and industrials and under weightings in financials and defensive-type securities. For November, the portfolio is up 8.3% as the market cycle changed. Over the10-year period the portfolio has netted 12.7% versus 9.4% for the Russell 2000. Over the 5-year period the portfolio has returned 9.4% versus 6.4% for the Russell. Over three years the returns are nearly equal. It will take some time for the current lagging of performance to close the gap. TCW has delivered 1000% cumulative excess returns over the Russell 2000 since the inception of this product and that out performance is expected again. The portfolio buys companies that are selling at discounts. The portfolio currently sells at 1.8x book value and 11x forward earnings. The debt to total capital is 30% of the portfolio and many of the companies are selling at $1 or $2 per share over the net cash in the balance sheets. In recent months companies in the portfolio have been acquired by other companies because they see the value that TCW saw when they bought them.

MR. GALLUCCIO reviewed the top 10 holdings in the portfolio, noting the diversification they represent. Together these holdings constitute 11.6% of the portfolio. The average market cap of the portfolio is below $1 billion. He noted that small cap stocks have a hard time when the Federal Reserve Board tightens money. In recent history when there have been periods of Federal Reserve tightening small cap stocks struggle. The current period reminded him of 1985 to 1995 when there was 15-month to two-year period of Federal Reserve tightening and when they went to a neutral stance the markets in both of those prior periods went up quite a bit.

MR. GALLUCCIO explained that recent under performance has been because of over weight in technology, under weight in financials, and over weight in producer durables and the like. With the current level of interest rates and a flat yield curve, regional bank stocks are beginning to be attractive and TCW is buying. Over time, buying companies without respect to the benchmark should be beneficial in terms of the performance of the portfolio. The P/E ratio of 23.6x compared to 19.2x for the Russell 2000 is skewed by the fact that TCW tends to buy companies with depressed near-term earnings because of a near-term issue. Looking out 18 months the P/E is 11x to 12x, so it is very cheap. MR. GALLUCCIO stated the portfolio is divided into four categories, among which are turnarounds and undervalued growth where there is the most value.

MR. O'LEARY noted that while the firm is a bottom-up stock selector, it is clear there is an embedded economic outlook that supports the firm's analysis. He noted that some wonder if the economy will soften significantly next year and asked how that is considered by TCW in looking at cyclically sensitive stocks. MR. GALLUCCIO replied that currently bad news is bad news; stocks can be hit hard when companies show a slowdown in bookings or disappointing earnings. If the economy slows next year, the Federal Reserve will have stopped tightening and maybe even be in an easing mode and the stock market might experience a temporary slowdown. The companies in which TCW is invested have lean inventories. If the economy slows down the beneficial effects of the Federal Reserve easing or no longer tightening will outweigh a slower earnings growth because the stock market will reward that earnings growth with the liquidity that will come back into the sector.

MR. O'LEARY asked what is a reasonable net of fee premium to expect in this product over a reasonable period of time. MR. GALLUCCIO replied that through bull and bear markets 200 basis points net of fees over and above the Russell 2000 is a reasonable expectation; TCW has delivered that over time.

TCW Energy Fund X

MR. THOMAS reviewed the TCW Energy and Infrastructure Group, which is comprised of 19 professionals operating out of four offices. Of the 19 professionals there are 6 engineers, of which 4 are petroleum engineers. The Group does most of its own engineering analysis, which is important in the type of illiquid investments made by the firm. He quickly reviewed the performance history of the funds managed by this group, including the Fund X in which the State is invested; the Group has done 12 funds. The Group has raised $6.1 billion in committed capital and has made over 170 portfolio investments.

MR. THOMAS reviewed both the oil and the gas markets. Oil is currently demand driven, rather than supply driven, as has been the case in the past. Historically there have been excess supply that has been controlled by Saudi Arabia and they have been able to control the amount of reserve margin in the market at any point in time to dictate prices. The total global supply is currently 85 billion barrels of oil a day and demand is 83.5 million barrels a day; leaving 1.5 million barrels a day of reserve margin, an historically low level. When the reserve is this low, everyone becomes a marginal producer. This will likely not change in the near term. Global demand is growing 1.5 million barrels per year, much of that growth coming from Asia. MR. THOMAS explained that the US represents 5% of the world's population, but it consumes 25% of the world's energy. Asia represents 37% of the world population but consumes 11% of the world's energy. As Asia continues to develop, they will consume more energy. As this happens, global demand will continue to grow.

The natural gas market is fundamentally different from that of oil; it is a regional market that is constrained by transportation. While there is plenty of natural gas, it is not located near large consumption markets. There is no global price of natural gas. With the growth of LNG, that may change in time, but MR. THOMAS believed it is a long way off. He believed the environment will be high priced for the medium term. He defined high price as above $40 oil and above $6 gas. Prices are above this for the medium term and volatility is all on the up side.

MR. THOMAS reviewed CH4 Energy, which is located in the North Sea, a holding of the Fund. This holding is unique as the drilling platform sits in the southern North Sea on the median line between the UK and the Netherlands. A treaty governs the operation of this platform. MR. THOMAS explained that TCW is a global energy investor and the portfolio contains international energy holdings.

MR. THOMAS noted that TCW pursues the value chain in energy from well head to spark spread; that is, from development in the field to putting energy out in the form of electricity. Focusing on the North American gas market, MR. THOMAS reviewed the current natural gas supplies in the US. Currently, 23.6% of natural gas in the US is imported from Canada and 2.6% from LNG; the US is a net exporter of natural gas to Mexico. Currently 35% of the supply comes from the Gulf of Mexico, which was affected by recent hurricanes. Canada cannot deliver more gas and the Gulf of Mexico is declining 2% annually, while demand is increasing 1% to 2% annually. In 2010, the Gulf of Mexico will drop from 35% to 25% of supply through natural depletion of those fields. Canada cannot supply more and the amount it is supplying is likely to decline. As a result, LNG will have to increase from 2.5% to 10% to 12% in 2010. Domestic onshore supply has stayed flat at 40% with the re-emergence of unconventional gas. Conventional gas is the typical sand-based reservoirs in the Gulf of Mexico, while unconventional gas is trapped in rock, shale, and coals. Extraction of unconventional gas is more expensive. The primary issue with respect to LNG is permitting. The risk is in terms of delay. The only reasonable source of gas other than LNG is Alaska gas. He believed both Alaska gas and LNG would have to materialize in order to meet demand.

COMMISSIONER CORBUS asked what is the anticipated growth in natural gas consumption between 2004 and 2010. MR. THOMAS replied that growth is anticipated at between 1% and 2%. Residential conversions to gas and power generation contribute to growth side, while there is demand destruction in the industrial sector because the cost of gas is so much lower in areas outside of the US.

MR. THOMAS stated that power comes down to fuel choice. It is the largest cost in generating electricity. The choices are coal and natural gas. The total dispatch price for coal-fired is less than $38 a megawatt hour, versus natural gas at $91.65 per megawatt hour. There is an imperative to have a more environmentally friendly fuel choice, but fundamental economics will not allow it.

MR. THOMAS stated there are four unconventional gas investments in the portfolio. The US power market is recovering and the portfolio holds two investments in that market. TCW is active in the North Sea through CH4, and the portfolio also includes two enhanced recovery/fuel additives investments.

MR. THOMAS stated that TCW believes unconventional gas will continue to be important. A higher level of technical skill is required to invest in unconventional gas; production costs for unconventional gas are higher than for a conventional well, so a higher priced environment is necessary for unconventional gas investment. In that environment, TCW hedges at the portfolio company level.

MR. THOMAS stated the power market continues to rebound with opportunities being presented in restructured gas-fired plants and coals.

MR. THOMAS stated the Fund's investment is in a $734 million commingled fund. The Fund is invested through a separate account. There are 101 participants in the fund. The fund is involved in nine transactions. When the fund was closed the price scenario was $30 oil and $5 gas, while the current market is $12 gas and $57 oil. The price bet for new investments is $40 oil and $6 gas. The portfolio is carried at the lower of cost or impaired value. Nothing in the portfolio is impaired at this time; the IRR based on projections is 15%, while the actual IRR is higher. To date, $311 million has been invested, which is 97% of projection. Distributions began to pay shortly after the fund closed; to date distributions are $13 million. Distributions should grow quarterly into the future. The state invested $80 million of the $734 million and just over $34 million of that has been funded to date.

MR. THOMAS reviewed the cash flow composition of the portfolio by investment and its principal and income; income is a function of yield and average life. VeraSun, USA Compression, and CH4 are the best performers; none of the investments are under performing. Cash flow components are yield enhancement/gains, interest/dividend, and principal.

MR. BADER noted the state committed $80 million to the Fund and understood at that time that no more than $50 million would be invested at any one time. He asked what is the anticipated high water mark for funds invested. MR. THOMAS did not expect the high water mark to be more than two-thirds of the total commitment. He noted that the pace of distributions would increase. The expectation is full investment, but for at least one-third of capital to be returned before the last capital call is made. MR. BADER asked if the other funds operated by this Group represent other investment opportunities. MR. THOMAS explained there are two types of funds in which TCW invests. The first is commingled funds that are unleveraged and focus on mezzanine and non-control equity positions principally in the US, western Europe, and Australia. It is this type of fund in which the State is invested. TCW also manages a series of leveraged funds that are called “global product funds.” These are securitization vehicles where portfolios are constructed of energy and infrastructure investments. These tend to be senior or high yield debt positions. Additional return is created through leverage in the portfolio.

DR. MITCHELL noted that more managers are getting into this area of investment. He asked whether there would be greater competition for the deals and would the pricing become less attractive. MR. THOMAS agreed that hedge funds are active in energy at this time, primarily in easily understood gas and oil plays. That is partially why TCW is active in unconventional gas, which requires particular technical, industry, and sector expertise. Seven or eight years ago Enron was active in energy financing, as were other energy companies, all of which directly competed with TCW. TCW does not try to compete in that market. At that point, TCW saw better opportunities outside of the US and built up its franchise in the North Sea. TCW views a broader playing field and allows plenty of time in the investment ramp-up period.

MR. THOMAS next reviewed the portfolio diversification by sector, geography, and asset type. He explained that ramp up is currently at 97% of projection. MR. THOMAS briefly reviewed several individual investments including Aurora Antrim North, Bowery Bay Energy/Astoria Energy, CH4 Finance, LaPaloma Holding Company/CEH, Steadfast Resources, Trident Resources, and Trust Energy Company/NAMI.

MR. O’LEARY asked that Bowery Bay be used as an example of how return is created. MR. THOMAS explained the interest rate on this investment is fixed, as are most of TCW’s investments. The intent is to achieve a certain return in the portfolio; 7% to 8% was targeted as a current return figure for the portfolio. A model was built projecting the cash flows of this project over the next 15 years. From a risk standpoint, an IRR of 14% to 15% was established and TCW determined how much of the cash flow is needed to achieve that rate at maturity; that figure was 13% of cash flow.

MR. O'LEARY noted that yield enhancement for Aurora is 4% overriding royalty interest and projected IRR is 16%. He asked how future prices for gas is estimated. MR. THOMAS explained this investment was structured with an 11.5% coupon. A royalty interest, which is a real property interest in each unit of hydrocarbon, is the preferred yield enhancement. There is a secondary market in royalty interest, so that could be sold if found desirable. The royalty interest is based on a negotiated geographic area. When TCW negotiates royalties, it is priced at TCW's price estimate, so if the actual selling price is higher, value is created. Also if more wells are drilled than were financed, the negotiated royalty rate is paid off the top to TCW. MR. O'LEARY asked how this investment could go sour. MR. THOMAS stated the standard in this business was that transactions involved royalty interest. More and more that is not the case. There are investments in this portfolio where there is no royalty interest. MR. O'LEARY noted that if prices collapsed, the investment would not get a return. MR. THOMAS confirmed this is the case. He noted that in order to get capital back, Aurora was required to hedge 75% of production.

MR. O'LEARY asked when Fund XI might be started. MR. THOMAS expected to be talking about Fund XI this time next year. MR. O'LEARY understood that a new fund would not be raised until the existing fund is funded. MR. THOMAS explained a new fund is raised when an existing fund is 75% funded.

BREAK 3:30 p.m. to 3:45 p.m.

9. Brandes Investment Partners

For more information on this presentation, please refer to the document entitled "Alaska State Pension Investment Board" dated November 29, 2005 and kept on file at the ARM Board offices.
MR. BADER explained Brandes manages an international equity mandate for the defined benefit plans and is an investment option in the defined contribution plans. After introduction by Mr. Bader, GLENN CARLSON and JUAN BENITO presented to the Board. MR. CARLSON stated Brandes runs a non-US equity portfolio for the state with a restriction of no more than 3% cash. The firm was founded in 1974 and has slightly over $100 billion in assets under management. The investment approach used by the firm is a Graham & Dodd approach, bottom-up, value style. The firm does not believe that stock markets are efficient. Companies are bought when share prices are well below the long-term value of those businesses. This often means investment in industries, regions, or companies that have a substantial amount of associated controversy. Brandes is based in San Diego and has over 500 employees; the firm is and has been 100% employee owned and this will not change.

MR. CARLSON noted that there are no products open in either the global or international products. The US Large Cap Value Equity and fixed income products are open. MR. CARLSON stated he and Mr. Benito work together as a team to manage the state's portfolio. The firm believes that if it is a disciplined investor, it can exploit inefficient prices in the stock market. A reasonable estimate can be put on the value of most businesses and that is what Brandes does through its research. The firm then looks for opportunities when the stock market allows shares of these businesses to be bought at discounts to Brandes's estimate of its long-term value. The stock market is one place where it is possible to buy at large discounts. Brandes buys businesses and holds onto them for a long time. At the end of the day, the firm ignores what the stock market says in terms of weightings in industries, bad news, etc., using its own analysis to determine value in investments.

MR. CARLSON reviewed the firm's investment process, explaining that the firm has global industry research teams that investigate companies and make fair value estimates. These teams present their research to the Investment Committee that is responsible for determining the organization's view on the fair value of a company and what discount is desired. The buy and sell decisions are related to the portfolio management teams, which build portfolios. The portfolio is nearly fully invested at all times with between 45 and 75 stocks. There can be no country or industry weighting at the time of purchase of 20% or 150% of the benchmark weighting. There is no currency hedging. Brandes identifies inefficiency, puts it into a portfolio, and allows it to become fully valued in the market. The downside to this approach is that portfolios are very different than the market indices. As a result, there are times of substantial under performance.

Brandes sells a company when it reaches its targeted sales price, when price appreciation results in rebalancing the portfolio, when the research process presents a better alternative, or when there is a change in company fundamentals that materially reduces the margin of safety for that investment. The turnover for portfolios is typically low at 20% to 40% annually.

MR. BENITO reviewed the performance of the state's portfolio versus the MSCI EAFE Index. Since inception in 1997, the state's portfolio has outperformed the index, most significantly in recent times. He explained the state contributed $375 million in the first two years and in the last 2.5 years the state took $325 million; the portfolio now has $640 million. Since inception the account has grown 12.86% while the index has grown at 4.04%. The last year has not been a relatively good period, but over longer-term periods the portfolio has out performed. Brandes does not attempt to forecast the future, it determines what companies are worth and holds them until the market realize their value. As a result, the portfolio is sometimes very different than the index.

MR. BENITO stated that year to date the key negative performance factors have been over weighting telecommunication stocks and under weighting oil and gas. As stock prices for oil and gas companies have gone up Brandes has been selling them, so the state has no exposure while the index has 9%. There are 16 industries in the index, so the over weight and under weight of these two industries has significantly affected the portfolio vis-à-vis the index. MR. CARLSON noted that in a period of time when oil and gas stocks are doing well, Brandes is selling them, and when automobile stocks are struggling, Brandes is buying them. Brandes tends to be quite contrarian in terms of its decision making.

DR. MITCHELL asked if the diversified telecom services exposure is over the 20% limit. MR. BENITO explained that the 20% restriction is applied at the time of purchase. This industry weighting is over the 20% limit primarily because of appreciation. Last year the State took $211 million from Brandes. When this occurs, Brandes can either take a small portion of every stock or to sell less attractive stocks. When the $211 million was sold last year, stocks from every sector but telecommunications were sold.

MR. BENITO explained that Brandes's analysts are organized by industry. Because Brandes runs a concentrated portfolio, one or two stocks might represent an industry. In the last year not many changes have been made to the portfolio. There have been significant increases or decreases in only three industries. He explained that Brandes does not have star analysts and does not attempt to figure out what will happen next, it finds stocks that will do better and, when they do, they are sold. He emphasized that the firm has not changed its philosophy over time. Products are closed in order to best serve its clients.

MR. O'LEARY recalled that during the first quarter that Brandes managed this portfolio several Japanese brokerage firms were purchased, one of which went bankrupt within the first three to four months of purchase. He agreed with the disclosure that the firm is unbenchmark-like and that they typically are buying stocks when they are unattractive. MR. CARLSON reviewed several instances of stocks that were held by Brandes when they were unattractive in the market, but that ultimately yielded high returns.

MR. PIHL asked for discussion of Invensys. MR. CARLSON explained this company is a UK conglomerate that Brandes has bought for 5 years and it has been a mistake. Whenever Brandes has re-evaluated its investment in this business, there has been agreement that the stock should be held. Unfortunately, several months later new, unknowable information is revealed that proves the investment was wrong. This happens for Brandes because of its investment methodology. He explained that Brandes determines whether there is an opportunity to make money from this point forward and bases its buy decision on that analysis. MR. BENITO explained that a "mistake" to Brandes is when a company is not valued correctly, not if the stock market goes down after the stock is bought.

10. BlackRock Financial Management

For more information on this presentation, please refer to the document entitled "Alaska Retirement Management Board, Portfolio Review" dated November 29, 2005 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, BARBARA NOVICK, ANDREW PHILLIPS and DIANE PARISH presented to the Board. MS. PARISH explained that BlackRock has managed on behalf of the State since June 1999 and has achieved out performance since inception. MS. NOVICK noted that BlackRock is known as a fixed income manager, but also manages equity and alternatives, as well as liquidity. She noted that Eileen Byrne joined BlackRock after leaving Townsend, the state's real estate consultant firm. BlackRock was established in 1988 and all founding partners remain actively involved with the firm. The firm has 1600 employees around the world in many countries. Importantly the employee base of the firm is stable. The firm has always been independently managed and is now a public company; the company is owned 60% by PNC Bank in Pittsburgh, 25% by employees, and 15% by the public. Equity distribution has been widened among employees in order to keep stability within the firm. As a public company the firm has independent directors, so there is a good governance structure that protects the firm and its clients. MS. NOVICK noted that BlackRock conducted a client satisfaction survey and the results were very positive. When BlackRock was hired, the idea of leveraging staff was discussed. Bob Mitchell calls on BlackRock from time to time. BlackRock was also hired to bring a different investment strategy to fixed income that complements the state's in-house portfolio. BlackRock also provides insurance in the event that something happens with the in-house portfolio. Risk management is a hallmark of the firm. The firm provides risk analytics for over $3 trillion in products over which it is not the manager.

MS. NOVICK stated the firm has no regulatory issues. The headquarters of the firm are in New York and the entire fixed income team is located there. There is also a large presence in real estate portfolio management and client service in San Francisco. The core bond mandate, which is the state's investment with BlackRock, is broadly based within the fixed income sectors. Over time, the business has become global with a broad variety of large institutional clients.

MR. PHILLIPS reviewed the firm's investment philosophy and process. Duration control is an important aspect of the firm's management. All fixed income mandates involve the selection of a benchmark and the duration of the benchmark is monitored daily; portfolios must remain within a range around the benchmark. The firm adds value by choosing sectors and choosing securities.

MR. BADER asked for a definition of "duration." MR. PHILLIPS explained it is the sensitivity of a bond's value to a change in interest rates. In bonds the primary risk is whether interest rates go up or down. BlackRock explicitly controls duration risk within a given portfolio. The firm adds value by choosing sectors and securities.

MR. PHILLIPS explained the securities selection process is both top down and bottom-up. The top down process involves examination of macro factors such as duration, yield curve, and broad sector allocation. The firm's Investment Strategy Group sets the overall investment themes, which is the top-down portion of the process. Formal meetings occur weekly, culminating Wednesday mornings with a meeting chaired by the CIO. Minutes of these meetings are available to clients on the firm's website. Once the macro themes are determined, individual securities are selected through a bottom-up process; this is the strength of the firm. MR. PHILLIPS reviewed the fixed income portfolio management team on page 8 of the presentation. He explained that senior portfolio managers have ultimate responsibility for the portfolios under management.

BlackRock conducts credit research through an experienced, growing team that has doubled in size over the last four years. The team is also a resource for the firm's clients.

MR. PHILLIPS commented that BlackRock's commitment to risk management sets it apart. The firm has established a separate, standalone business that sells risk management services, software and systems. BlackRock has the unique ability to invest resources in risk management, allowing it to stay on the cutting edge. He emphasized that risk matters in fixed income, noting that in recent years there are hundreds of basis points difference in performance between the best and worst performing managers.

MR. O'LEARY explained that in each of the troublesome years for the bond market where returns were quite wide BlackRock's performance was median or better. MR. PHILLIPS explained that BlackRock added value versus the benchmark during those years. MR. O'LEARY stated he has been astounded that the firm has owned its share of bankruptcies but that has never detracted significantly from performance. MR. PHILLIPS felt this was where the firm's culture comes into play. The firm makes mistakes, but the key is that when a mistake is made, damage should be minimized. The firm cannot promise perfect foresight, but it will be aware of the risks and how much the risks mean to its clients.

MR. PHILLIPS explained BlackRock has held the view for some time that interest rates in the US are too low relative to fundamentals, the most important of which are growth and inflation. Real GDP growth has been between 3.3% and 4.3% for eight consecutive quarters. Real economic growth in this range is expected. Adding core inflation of 2% to real GDP totals 5.5%, so long-term interest rates should be at 5.5%, while a 10-year yield today is 4.5%. BlackRock believes that in time an upward revision will be made in interest rates. BlackRock also thinks spreads are too tight. The firm's concern is that with the quietness of the markets, there has become a degree of complacency in the fixed income markets that has created a tight spread; particularly, credit spreads should be wider. BlackRock is defensively postured in the portfolios because of this concern.

MR. PHILLIPS quickly reviewed the state's portfolio as of year-end 2004 and end of third quarter 2005. As of year-end 2004 the portfolio was defensively postured; the portfolio yield was 36 basis points below the market. At the end of the third quarter 2005, the portfolio has slightly more yield than the benchmark. There has been some repricing in the fixed income market in the last several months. BlackRock has added some interest rate exposure and credit exposure as a result. MR. PHILLIPS stated the state's portfolio has performed well historically and has returned 36 basis points above the benchmark year-to-date.

RECESS 4:45 p.m.

ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location of Meeting
Anchorage Marriott Hotel
820 West 7th Avenue
Anchorage, Alaska

MINUTES OF
November 29-30, 2005

Wednesday, November 30, 2005

I. CALL TO ORDER

VICE CHAIR TRIVETTE called the meeting of the Alaska Retirement Management Board to order at 9:00 a.m.

II. ROLL CALL

ARM Board Members Present
Martin Pihl
Sam Trivette
Gayle Harbo
Gail Schubert
Larry Semmens
Bob Roses
Commissioner Scott Nordstrand
Mike Williams
Commissioner Bill Corbus

Consultants Present
Rob Johnson, Legal Counsel
Michael O'Leary, CAI
David Slishinsky, Buck Consultants LLC

IAC Members Present
Tim O'Brien
Bill Jennings
Jerrold Mitchell

Revenue Staff
Tom Boutin, Deputy Commissioner, Department of Revenue
Gary Bader, Chief Investment Officer
Susan Taylor, Comptroller

Steve Sikes, State Investment Officer
Zach Hanna, State Investment Officer
Judy Hall, Liaison Officer

Department of Administration Staff
Kevin Brooks, Deputy Commissioner, Department of Administration
Melanie Millhorn, Director, Division of Retirement and Benefits, Department of Administration
Charlene Morrison, Chief Financial Officer, Department Of Administration
Traci Carpenter, Department of Administration

GARY BADER advised the ARMB that a capital call was placed in the office requesting $5 million for a private equity venture that is not one in which the State participates; there is a fraud scheme involving pension funds. The staff caught this and reported it to the Attorney General's Office. He also noted that in his report yesterday of authority delegation he had omitted the name of Judy Hall with respect to alternative investments, real estate, private equity, absolute return, agriculture, and the REIT program. He explained that for some time Ms. Hall has been assisting in the investment program in addition to her duties as liaison for the ARMB.

11. Introduction of Actuary

For more information on this presentation, please refer to the document entitled "State of Alaska, Alaska Department of Administration, Retirement and Benefits, Presentation off Actuarial Services" dated November 30, 2005 and kept on file at the ARM Board offices.

MELANIE MILLHORN, Director, Division of Retirement and Benefits, introduced David Slishinsky with Buck Consultants LLC. She explained that the Division of Retirement and Benefits issued an RFP in July 2005. As a result of that RFP, a proposal evaluation committee was convened consisting of Gary Bader, Charlene Morrison and Kevin Ritchie with the Alaska Municipal League and herself. Based on the proposals received, Buck Consultants was selected. A recommendation was presented to the ARMB on October 12, 2005 to retain Buck Consultants as the actuary and the ARMB gave is approval.

DAVID SLISHINSKY, Principal and Consulting Actuary with Buck Consultants LLC, stated the firm is excited to be the actuary for the State's retirement systems. He explained that Buck Consultants is a leading actuarial and human resources consulting firm with 56 offices worldwide with 2,000 employees. There are approximately 30 offices in the United States. The western region offices will serve the State of Alaska. The firm has 2,500 clients, many in the private sector, many nonprofits, and public employers. Of the 600 retirement professionals providing retirement consulting, 80 are Fellows of the Society of Actuaries, 109 are Associates of the Society of Actuaries, and 191 are Enrolled Actuaries.

The firm was founded in 1916 as George Buck saw an opportunity to help the City of New York and other municipalities that were beginning retirement plans. He pioneered the pre-funding and design of pension plans in those days. This firm does probably more public sector work than any other actuarial firm, currently serving as actuary for more than 60 statewide public employee retirement systems serving 3.7 million members with over $356 billion in assets.

In 1997 Buck merged with Mellon Bank, which had been a client of the firm for over 50 years. Because of potential conflicts of interest in the lines of business, Buck was spun off and sold to Affiliated Computer Services (ACS) in May 2005. ACS was founded in 1988 by computer professionals. It is a Fortune 500 company that has $5 billion in annual revenue. ACS is primarily an outsourcer of business processes and information technology to commercial and governmental clients.

In addition to retirement benefits consulting, Buck does consulting in health and welfare benefits, offers tax and legal services, communications services, compensation services, and strategic planning/human resource management consulting. MR. SLISHINSKY reviewed the states for which Buck provides public pension fund consulting services.

CHAIR SCHUBERT arrived at 9:10 a.m.

MR. SLISHINSKY also noted the states for which services have been provided in the last five years. In total, Buck is providing services or has provided consulting services in the last five years to all but four states. MR. SLISHINSKY reviewed the statewide retirement systems for which he provides actuarial services, as well as those for which Kim Nicholl, a resource actuary out of Chicago, provides services.

MR. SLISHINSKY reviewed the structure of Buck's Alaska Team. The actuarial services for the State of Alaska will be performed in Denver. Ms. Nicholl will do peer review, reviewing the work before it is presented to the State of Alaska. Health and welfare actuaries in the firm's San Diego office will also provide services to the state, as will two health and welfare consultants in Denver. MR. SLISHINSKY reviewed the staff members who will be serving on the State's team in Denver.

MR. SLISHINSKY stated Buck has substantial expertise in Denver providing services to statewide systems. Three senior actuaries provide primary service with two additional senior actuaries providing actuarial service. The firm has a proven track record in providing quality service, clear communications, and sophisticated tools. The firm's consulting approach is proactive, providing timely advice on trends in the retirement field, anticipating the needs of the client, sharing innovative ideas and solutions developed by other statewide systems, and providing strategic thinking. Buck often does special one-time projects when a state is dealing with a particularly complicated issue.

MR. SEMMENS asked whether when Buck does a special project, such as assessing the impact if the legislature proposes changes to the system, the ARMB would contract with Buck to perform that work. MR. SLISHINSKY replied that if legislation is proposed that affects the system, Buck would work with the board to assess the fiscal impact. MR. SEMMENS asked if only historical information would be used to project those impacts, or would actual future impact be projected. MR. SLISHINSKY replied that typically it is an extension of the actuarial evaluation process, which is a snapshot. In the explanation of the results, however, Buck provides information about not only what change would occur in the contribution rate in the current year, but also what it is likely to be in future years. He noted that many systems have taken advantage of the build-up in assets over the late 1990s and improved benefits only to see that the assets fell back in early 2000; those systems are now looking at funding shortfalls.

MR. JOHNSON asked what approaches Buck intends to take with respect to taking over a portfolio from a previous longstanding actuary. MR. SLISHINSKY replied that the first step is to replicate the last actuarial calculation done by the previous actuary. The data they used will be put into Buck's system and Buck's system will be programmed to match the state's benefit structure, to use the actuarial assumptions used by the prior actuary, and replicate those calculations using Buck's valuation system and computer model. This helps Buck understand what was involved in the calculation of those numbers. The results of this work will be reported to the board, as well as commentary on the actuarial assumptions, actuarial methods, and any issues Buck sees.

MR. TRIVETTE noted there was also an audit by Milliman in 2002 that Buck might find helpful. MR. SLISHINSKY stated he is in possession of that audit. MR. TRIVETTE suggested that Buck also review the minutes of the ARMB's last meeting where questions were raised to the previous actuary.

MS. MILLHORN asked whether, if the board wanted to look at a particular area and forecast into the future, given any set of scenarios, Buck has the tools to do that. MR. SLISHINSKY replied the firm has that capability, but there is a certain amount of work involving projection and modeling that is included in the fee quote and contract and things outside of that would be out of the scope of the contract. Buck would inform the client of any additional costs.

MS. HARBO noted that Milliman had suggested Mercer use the Entry Age Normal method that is used by 70% of pension plans, but they chose not to use that method. She understood under the Entry Age Normal method assets are accumulated more slowly. MR. SLISHINSKY replied that the cost is determined as a level percentage of payroll under the Entry Age Normal method. That is, the amount is as contributed from date of hire of all members until the assumed retirement date of all members so that the amount accumulated is sufficient to pay for their retirement benefits. That benefit payment is prefunded. That contribution pattern is as a level percentage of pay from date of hire until retirement, assuming that all of the actuarial assumptions are realized. Under the Projected Unit Credit method that is currently being used, there is a continually increasing contribution rate to pay for the cost of the accruing benefit. It replicates more the way in which the value of the benefit accumulates, however, it results in an increase in that rate as a member ages. As there are changes in the ages of members, there will be changes in the normal cost of the benefit. MS. HARBO asked what method Buck uses in doing its assumption. MR. SLISHINSKY replied that Buck uses Entry Age Normal primarily because it provides a level cost on a normal cost basis. Over the short-term there are fluctuations of gains and losses, primarily on the investment side, with mature pension funds. There are also gains and losses on the demographic side that impact the unfunded liability that then impacts what the employer has to pay each year in order to meet the cost of the accruing benefit and amortizing the unfunded liability.

MR. O'LEARY asked what kind of discount rates are being used in the public sector. MR. SLISHINSKY replied the most common discount rate for valuation purposes is 8%, primarily because most systems have an asset allocation of 65% equities and 35% fixed income. There is a professional requirement for actuaries in setting economic assumptions to comply with the Actuarial Standards Board standards of practice published by the American Academy of Actuaries. Buck looks at how the assets are invested, what is the investment policy of the system, and uses historical information and future expectations to develop an investment return assumption. This is a long-term funding horizon because the method projects benefit payments into the future. For this reason, Buck looks primarily at historical information.

MR. PIHL remarked that the state's retirement system has been using data that is two years old and contribution rates are then set to start one year into the future. He found this unacceptable in this age of computers. He asked if the timelines could be brought together. MR. SLISHINSKY replied that the sooner the data is received, the sooner results can be produced. MR. PIHL stated that unless the dates are brought closer together, there would continue to be an undesirable situation. He hoped that Buck would advise the systems, in addition to providing actuarial services. He further noted that Alaska is unique and national data will not work here. Alaska is a young state building possibly expensive facilities to bring quality healthcare to Alaskans. MR. SLISHINSKY voiced appreciation for these comments. He indicated he spent two and one-half weeks in Alaska this summer during which time his wife broke her foot near Glennallen. This offered an opportunity for him to experience the healthcare system in Alaska. He stated Buck treats every client as unique and certainly Alaska has many unique aspects. MR. PIHL felt the assumption that medical costs will trend down to 5% is incorrect for Alaska. MR. SLISHINSKY stated he is a pension, not a health plan expert. This is why there are healthcare consultants on Buck's Alaska team.

MR. ROSES understood Buck will use a different method than did Mercer and asked if that method would be used when Mercer's work is replicated. MR. SLISHINSKY replied that first everything will be replicated, then the Board will be presented with those results as well as comments about what works and what does not work, and what Buck thinks should be changed. He stated the Projected Unit Credit method, especially in terms of defined contribution, will have to be reviewed closely by Buck as part of its analysis. The firm will look at what changes there would be by shifting to the Entry Age Normal method. MR. ROSES understood the purpose of replication is to build historical knowledge so that Buck can provide advice on potential changes from Mercer's work. MR. SLISHINSKY noted that he also questioned Mercer's return assumption of 8.25%, given the investment target of 67% equity and 33% fixed income. Based on that mix, the 8.25% assumption is aggressive. MR. ROSES asked what mortality table Buck uses. MR. SLISHINSKY replied that Buck uses the 1994 mortality table with improvement through 2002. Some new tables have been issued, but they are based on data collected in the private sector, not the public sector, so they are not recommended.

MS. HARBO explained that she also had a question regarding mortality tables out of fear of being impacted by a large change such as what occurred in 2000 when Mercer changed from the 1984 to 1994 mortality tables. She stated there is a mortality table 2000 that is based only on retirement plans. Her concern is that the state's system is using 1994 data; she understood the 2000 table is better to use for retirement plans. MR. SLISHINSKY explained there is improvement in tables over time and that improvement can be replicated with a setback. The pattern of the tables does not change over time; the probability of death does increase with age.

MR. WILLIAMS asked if Buck would proposes ideas or solutions to address shortfall or under funding issues as it replicates the previous actuary's work. MR. SLISHINSKY felt this was an issue of continuing discussion, particularly if the shortfalls are large. There is an issue of how to fund for that shortfall when it becomes so large. MR. WILLIAMS asked if this is within the scope of the contract with Buck. MR. SLISHINSKY replied that the meetings with the system are within the contract.

MR. SEMMENS noted there are some trustees who wonder if the previous actuary did or did not do a good job, given that in 2001 they said for the next 25 years the rate would be 6.77% but in 2003 they said the rate would be 24.63%. He remarked that Buck's presentation includes the statement "no surprises." MR. SLISHINSKY noted there were changes in methodology made that in essence immediately recognized the extent of the losses incurred from 2000 through 2002. He did not think the actuary would make that decision independent from the retirement board. MR. SEMMENS asked what accountability the actuary faces. MR. SLISHINSKY explained that communication is key; the client must understand what has happened and what could potentially happen. He presents not only the results, but also the underlying risk and what can change in the future that would affect the rates.

MR. TRIVETTE noted that another actuary report was done in May 2005 for the Legislature; he asked that Buck review that as well.

MS. HARBO noted there would now be no growth in the system. There is currently a $2 billion wage base for people in the system, but as more people retire that wage base will decrease. She asked whether there is any way to determine when the system will run out of money. MR. SLISHINSKY stated this was attempted for Colorado and the conclusion was that without making any changes they would run out of money, not in any particular year, but certainly after 2034. In Buck's process an open group projection is used. The key is what will happen with the membership group going forward when new hires will be covered with the defined contribution rather than the defined benefit plan. The process will consider the extent of that impact and Buck will project that to give the State a sense of what is expected to happen with respect to the number of people participating in the defined benefit plan going forward and what is the expected payroll. MS. HARBO asked if Buck would be able to determine what state appropriation would be needed to make the members of the current system whole. MR. SLISHINSKY replied that this would depend on how far out the projection goes; it is important to identify the trend. If there is a continuously downward trend, one could say the system will run out of money, although not when.

MR. SLISHINSKY continued his presentation. He stated Buck knows public plan practices, testifies before legislatures, presents to boards and staff, and meets with governors.

MS. HARBO noted that under GASB 45 the states that do not prefund would be really impacted. Alaska is ahead of the curve because it does prefund healthcare. She asked when the unfunded liability is put on the books for Nebraska, for instance, what will that do to their funding ratio. MR. SLISHINSKY replied they only provide access, not a healthcare plan. MS. HARBO remarked that some states do provide a healthcare plan, so they will look bad when this requirement comes into place. MR. SLISHINSKY explained that an under both GASB 43 and 45 the discount has to be based on the cost of prefunding the benefit; if it is not prefunded, a short-term rate must be used, which increases the size of the liabilities. Because the State prefunds this benefit, it can use the higher discount rate to match investment of the funds and book a lower liability.

MR. SLISHINSKY stated Buck would help the state maintain the security of member benefits. Buck will do a one-year replication of the work of the previous actuary, will determine the funded status and employer contribution rates, performs a gain/loss analysis by source, provides a GASB disclosure, performs an experience analysis, and collaboratively set the assumptions with the ARMB. The firm will make presentations to the ARMB and staff, explain results, provide experience analysis results, and provide educational sessions. Buck will provide retiree medical consulting, legislative studies/cost notes on proposed legislation, asset/liability projections, tax and legal assistance, assistance with member communications, and will partner with Division staff.

MR. SLISHINSKY reviewed the annual processing schedule for the firm's work. Information was requested from the state and Mercer in November 2005, beginning the work, the actuarial valuation results will be completed June 30, 2006 with an ARMB presentation at that time. An experience analysis for 2001-2005 will be performed March-May, culminating with a report with actuarial impact in June.

MR. SLISHINSKY briefly reviewed the fees charged for the contract with the state and explained that a fee would be quoted for anything outside the scope of that contract. The goal of the firm is that there be no surprises.

MR. TRIVETTE remarked that assumptions were an issue with the previous actuary. An article in the *Wall Street Journa*l this last week notes that a quarter percent increase or decrease in the interest rate used to calculate total liability can change the size of the obligation by billions of dollars. There was a concern with the previous actuary that some of the changes in assumptions were a big factor in the fund level.

12. Financial Statements Report

CHARLENE MORRISON, Chief Financial Officer, Department of Administration, introduced Kathy Porterfield, managing partner for KPMG's Anchorage office, the Division's independent auditor. She noted that she disseminated the PERS and TRS Comprehensive Annual Financial Reports (CAFR) after Thanksgiving and some replacement pages have since been provided. The packet includes financial statements for the PERS, TRS, the Judicial and Military pension plans, the retiree health fund, the Supplemental Benefits System, and the Defined Contribution Plan. The material also includes letters issued by KPMG for each of the plans. CAFRs are prepared for the PERS and TRS to communicate additional information to the members. Each CAFR contains an introductory section, financial section, investment section, actuarial section, and statistical section.

MS. MORRISON first reviewed the PERS CAFR. The introductory section contains a transmittal letter from the Division of Retirement and Benefits (Division) to the Governor, the

State Legislature, members of the ARMB, employers, and plan members. It outlines the responsibilities of the administrators, the PERS Board, the ASPIB, and the newly formed ARMB. It also outlines the initiative underway in the Division to implement SB141 that created a defined contribution plan for PERS and TRS. This section also contains a copy of the Certificate of Achievement for Excellence in Financial Reporting issued for last year's CAFR. The Division will be submitting to the Government Finance Officers Association a certificate for the current reports as well. An organizational chart is contained in the report, as is a summary of section responsibilities within the Division and a listing of professional consultants used by the Division. Guidelines for the development of a CAFR require disclosure of information related to the plan's governing board. Given that the board changed after the period covered by the report but before it was issued, information has been provided on both the PERS and the ARMB.

The financial section contains the independent auditor's report, management discussion and analysis, basic financial statements, required supplementary information, and additional schedules. The PERS was established in 1961 to provide pension and healthcare post employment benefits to eligible State and local governmental employees. At June 30, 2005 there were 160 participating employers whose net assets were $8.6 billion. The State of Alaska is the largest employer and represents half of the plan's activities and assets. The plan's assets increased 5% in FY05 as a result of investment income and contributions exceeding benefit payments and administrative expenses. Contributions increased almost 31% over FY04 due to the increase in contribution rates set by the PERS Board. Those contribution rates are based on the 2002 actuarial evaluation, which is the one in which new actuarial assumptions and methods were implemented. These changes resulted in a decrease in the funding ratio for the plan and an increase in employer contribution rates to the maximum extent allowed by statute, which is five percentage points over the rate for the prior year. Net investment income decreased by 35% from that recognized in 2004. In 2004 there was an increase in investment income of 350% due to the returns experienced in that year. In 2004 the plan returned 15% on its invested assets and in 2005 the plan returned just under 9%. Investment income accounted for 82% of income in 2004, 75% in 2005, and over the last ten years investment income has accounted for 70% of income.

Benefit deductions increased by more than 10% from the last year, continuing a several year trend. Pension deductions increased 8.6% and healthcare increased 14.9%. Administrative costs were down 5.5% from the prior year. There is detailed information in the report regarding administrative expenses incurred with the Division and investment-related expenses incurred with the Treasury Division. The report contains schedules of funding progress for the system's pension and post-employment healthcare benefits, which shows a dip in the funding ratio with the 2002 valuation from 100% funded in 2001 to 75% funded in 2002 to 72.8% funded in 2003. With the evaluation approved by the ARMB last month, funding is 7.25.

The investment section includes a message from the ASPIB Chair, information related to the ASPIB members as of June 30, 2005, and a listing of the external consultants used by the Treasury Division. It concludes with a report prepared by Treasury's CIO. This section also includes historical return information. The ASPIB Chair reported that the plan experienced a 13.75-year cumulative annualized return of 8.69%. This section includes pie charts depicting the actual asset allocation at June 30, 2005 and 2004, as well as a listing of the ten largest bond and equity holdings. This section also includes total pension plan holdings by asset category, investment pools shared by the pension plan, and related fees paid by PERS. There is also information related to commission recapture and securities lending programs.

The actuarial section contains information from the actuarial valuation, including the certification letter, results of the 2003 valuation, and historical information related to the 2003 valuation and past valuations. There is also historical data related to the plan's unfunded liability. In 2004, the unfunded liability for PERS was $3.4 billion. There is historical information related to the actuarially determined average contribution rates and the average contribution rate adopted by the PERS Board.

The statistical section contains graphs and tables related to information to the plan.

MR. SEMMENS offered congratulations on receiving the Certificate of Achievement for Excellence in Financial Reporting.

MS. MORRISON next reviewed the TRS CAFR, which follows the same format as the PERS CAFR and contains much of the same information. TRS was established in 1955 to provide pension and post employment healthcare benefits to teachers and other eligible participants. At June 30, 2005 there were 58 participating employers with assets of $4 billion. Changes in the plan, contribution levels, investment income, and benefit deductions are the result of the same reasons as were discussed for PERS. Plan assets increased 3% and contributions increased 18%. The plan returned just over 9% in FY05 and just over 15% in FY04. Investment income represents 69% of the total income for the plan in the last 10 years. Benefit deductions increased 7.3%, comprised of a pension increase of 5.5% and healthcare increase of just over 13%. The TRS CAFR details administrative expenses incurred by the Division and investment expenses incurred by the Treasury Division. The report also includes schedules of funding progress for the system's pension and healthcare benefits, as well as historical return information provided by the Treasury Division. The cumulative annualized return for the 13.75 years was 8.75% for TRS. The report also includes the same listing of the invested assets as PERS, but reflects the fees paid by the TRS system.

MR. ROSES noted the 2004 funded ratio was 70.2% for PERS and asked what is it for TRS. MS. MORRISON replied that the TRS funded rate was 62.8% in the 2004 valuation.

MS. MORRISON explained the Judicial Retirement system and National Guard and Naval Militia system have audited financial statements, not CAFRs. Judicial was established in 1963 to provide pension and post employment healthcare benefits to eligible state justices and judges. Plan assets increased 4.6%, contributions increased 16%, and investment return in FY05 was 8.49% and 15.21% in FY04. Benefit deductions increased 7.6% with a 6% increase in pension and almost 18% for healthcare. Administrative costs decreased. The schedule of funding progress notes that the valuations for this system and the Militia system are done every other year. In the interim year, the actuary is asked to do a more limited review to ensure there are not significant changes. The funding ratio for the Judicial system at June 30, 2004 was 88%.

The National Guard and Naval Militia system was established in 1973 to provide pension and post employment healthcare benefits to eligible members of the Alaska National Guard and

Alaska Naval Militia. This system does not provide healthcare benefits. Assets were $14.5 million at June 30, 2005, an increase of 8% over the prior year. Contributions increased over 51% over last year's level due to an increase in the contribution rate that was set using the 2002 valuation. The 2002 valuation reflected an increase in the contribution rate due to increases in benefit costs and increasing membership. Investment income saw the same type of change as the other plans. The return on plan assets was 7.0% in FY05 and 9.4% in FY04. Benefit deductions increased 8.5% as a result of more members taking lump sum payments at retirement. The administrative costs remained stable. In 2004 the funding ratio was 67.8%.

MS. HARBO asked who contributes to the National Guard and Naval Militia system and how is their employer contribution rate calculated; why is their funding ratio so low. MS. MORRISON replied that the actuarially accrued assets and liabilities result in that funding ratio; it is paid by the state based on payroll for the system. MS. HARBO asked who sets the contribution rate for this system. MS. MORRISON believed this would be the responsibility of the ARMB. MS. HARBO asked who was responsible in the past. MS. MORRISON replied that responsibility rested with the Commissioner of the Department of Administration. MS. HARBO asked what was the employer contribution rate last year and this year. MS. MORRISON stated the required contribution was $2 million and the actual amount contributed was $1.9 million. She stated she did not have the employer contribution rate. MS. HARBO noted the funding ratio for this system is near TRS, yet they do not pay healthcare. She was curious who set the rate for the National Guard and Naval Militia. MS. MORRISON believed the Commissioner of the Department of Administration set that rate in the past. MS. MILLHORN confirmed this was the case. She explained that SB141 changes this authority to the ARMB for the National Guard and Naval Militia system only, not for the Judicial system. MS. HARBO asked that staff prepare information on those contribution rates for distribution to the ARMB.

MS. MORRISON reviewed information regarding the Retiree Health Fund, which was established in 1997 to provide self-insured healthcare benefits to approximately 27,000 retirees of the various pension plans. Because the plan is self-funded, the participants in the plan retain the risk of loss associated with allowable claims. Prior to the creation of this fund, benefits were fully insured through the payment of premiums to an insurance company. This fund collects premiums from the retirement systems and benefit recipients. Premium amounts are actuarially determined on an annual basis and are approved by the Commissioner of Adminstration. The Division administers the plan and the Treasury Division invests the assets. Net assets increased nearly 36% in FY05; health premiums increased 14% due to increasing costs associated with covered benefits. The Division's benefit consultant reviews historical claims experience, as well as administrative costs, and uses that data to help develop premiums for the coming year. Other income realized in FY05 is $4 million. This is income related to prescription drug rebates. Net investment income increased from prior year due to the return on fixed income. This plan invests 70% of its assets in fixed income and the return on fixed income rose from less than 1% in FY04 to more than 7% in FY05. The primary expense associated with this plan is benefit payments, which increased 12% in FY05 due to more members being in the plan and the rising costs of benefits.

MS. HARBO noted that in FY04 the Division saw an excess of medical reserve funds, so $20 million was sent back proportionately to the four systems. That brought the reserves down to $74 million. Since that time those reserves have grown to $138 million. Her concern is that this is not intended to be a savings account, it is intended to cover medical liabilities that are incurred in calendar year 2006. The anticipated percentage would be 15% to 20% of the liabilities are going to incur, which would mean perhaps $50 million could be put back to the trust funds managed by the ARMB so a better rate of interest could be earned. She assumed the Division is looking at sending that money back. MS. MORRISON noted that the report shows a major medical balance of $125 million. Management at the Division has been discussing this issue and is gathering information to see what suggestion might be sent to the Commissioner of Administration. That process should be completed within the next couple of months. COMMISSIONER NORDSTRAND stated the Division is actively examining what amount of money could be sent back to the trust funds while maintaining a reasonable reserve.

MS. MORRISON next reviewed the Supplemental Benefits System (SBS), which was created in 1980 to provide benefits in lieu of Social Security. The fiscal year for this system ends January 31st. As of the end of the fiscal year January 31, 2005, there were 15 other employers besides the State participating, which has approximately 33,000 participants. The Division is responsible for plan administration. ASPIB was responsible for investments through October 1, 2005 when the ARMB assumed that responsibility. There are two type of benefit plans in this system, the supplemental annuity that accounts for 99% of assets and the cafeteria plan. The plan is self-directed by participants. Net assets held in the trust at January 31, 2005 was approximately $1.9 million. Net assets increased 3.8% during the fiscal year.

MS. MORRISON reviewed the financials for the Deferred Compensation plan, which was created in 1974 under section 457 of the IRC. The year-end is a calendar year. Like SBS, this plan is participant-directed. Assets held in the trust at December 31, 2004 were $454 million. Net assets increased 10% in 2004.

KATHY PORTERFIELD with KPMG stated that the audit report for PERS does not cover the introductory section of the CAFR, management's discussion and analysis, supplementary information, or statistical sections and actuarial data. The audit is confined to the basic financial statements and footnotes. KPMG issued an unqualified opinion for each of the systems for which Ms. Morrison presented information. The audit report indicates the scope of the audit, the time period it covers, and the objectives of the audit. There is a statement in the report this year that this is not a Sarbanes-Oxley audit of systems of internal control. Internal controls are considered for purposes of designing auditing procedures, but KPMG's audit is not an opinion on internal controls. MS. PORTERFIELD noted that the Governmental Accounting Standards Board (GASB) issued a new statement in 2005 regarding investment disclosure. This statement is focused on more information about the risk in the investment portfolio. In prior years a disclosure was required of the types of investments in the system and some information about custodial risk. There must now be disclosure of interest rate risk, credit risk, and foreign currency risk, including policies and the actual result of those policies.

MS. PORTERFIELD stated that each set of financial statements include a letter from KPMG to the Board. These letters provided more information about the audit process, going beyond KPMG's opinion on the financial statements. The letter discusses accounting policies, whether the financial statements have been prepared consistently, whether KPMG has proposed any audit adjustments, and whether as a result of the audit tests performed KPMG has developed audit adjustments and requested adjustments, which did not occur. The letter also discusses KPMG's relationship with management, any difficulties getting information, any disagreements regarding accounting or financial reporting matters; there were none. The letter also confirms KPMG's independence from management. With the letter is any communication between KPMG and the Division. The only correspondence was routine in nature. A management letter was issued to the ARMB and, in the case of most of the plans, that letter was relatively generic. For the PERS and TRS there has been a comment in prior management letters and it was repeated in 2005 to do a CRS post-implementation review to ensure that it is working as efficiently as possible.

MR. O'BRIEN noted that the management letter for the SBS and Deferred Compensation plan discuss reclassifications where some investment income had been netted against expenses. He asked for a discussion of this issue. MS. PORTERFIELD recalled that this is a reclassification that has been required every year where the administrative expenses are reflected in the financial statements. It is not an adjustment to accrue any additional expenses. MR. O'BRIEN asked what are those expenses. MS. PORTERFIELD recalled that these expenses were general overhead. MR. O'BRIEN felt the audit fees are reasonable, but noted that the relative increase in fees from 2004 to 2005 was substantial. He asked if that a reflection on KPMG's reporting requirements or were there difficulties in the audit. MS. PORTERFIELD replied that the schedule is typically on a payment basis as opposed to an accrual basis, so the comparison might not be "apples to oranges." She stated there were no significant difficulties that resulted in additional audit fees. More time was involved in the audit this year because there was staffing turnover.

MR. SEMMENS asked what work the firm does to be satisfied that private equity securities, absolute return investments, energy-related investments, and real estate investments are fairly valued. MS. PORTERFIELD stated that audited financial statements are typically received hopefully within six months of the date being reported on in order to determine whether or not KPMG agrees these investments are appropriately valued. KMPG reviews whether the auditors have rendered an unqualified opinion on the financial statements and then tries to get information to update the audit, if necessary. Audits were not received on all investments because they are not material to the financial statements taken as a whole.

COMMISSIONER CORBUS asked for an explanation of the process to confirm the system holds the assets shown in the statements. MS. PORTERFIELD replied that KPMG confirms 100% of investments with the custodian and if there is not a custodian KPMG would go to the manager that actually holds the evidence of ownership. COMMISSIONER CORBUS asked what is done in terms of investigating the custodians. MS. PORTERFIELD explained that KPMG does not audit the internal controls or processes of custodians, but their auditors issue an extensive report on the audit work they perform and they issue an opinion on the internal controls of the custodian. She suggested that the ARMB receive a presentation on this report at some point so it understands this review. In this case, KPMG was satisfied with the scope of the auditor's work on the custodian. This report also includes recommendations regarding the controls the administration should have in place and KPMG tests to be sure those are in place. COMMISISONER CORBUS asked if there was anything else during the audit that gave KPMG pause for thought. MS. PORTERFIELD replied in the negative. She stated that as a new board there is information that the ARMB should review to ensure it is comfortable with the controls that are in place. MS. TAYLOR indicated that she is verifying that necessary controls are in place, given the staffing turnover. MS. PORTERFIELD agreed that this is important for the coming year audit.

BREAK 10:50 a.m. to 11:00 a.m.

13. Plan Change for Deferred Compensation Plan; Judicial Retirement System

MELANIE MILLHORN, Director, Division of Retirement and Benefits, explained that in June of 2001 Congress enacted the Economic Growth and Tax Reconciliation Act. As a result of that law, the State's plan was amended effective January 1, 2002 to include spousal beneficiary waiver form requirements. The Department of Law indicated a need to include a provision that spousal rights are conferred based on this plan change to affect all members and beneficiaries regardless of the original submission date of beneficiary forms. The Division wishes to notify all members that this change will be for all members affected and that it will provide, at a minimum, a 50% benefit to the spouse. If the member chooses to designate someone other than their spouse as a greater than 50% beneficiary, a spousal waiver form must be on file with the Division.

CHAIR SCHUBERT asked whether, from a marital law standpoint, requiring a spousal waiver form implies rights that the spouse may or may not have. MS. MILLHORN replied that this issue was discussed with both Deloitte Consulting and with the Department of Law. The Division believes this conforms with the IRC 457(b) and the State's plan documents to ensure the spouse receives, at a minimum, 50% of the benefit if there is no waiver. CHAIR SCHUBERT hoped that this does not create more problems for the Division.

MR. TRIVETTE asked for copies of the discussions and/or correspondence regarding this plan change. He asked whether Mr. Johnson has or should review this and offer an opinion. MR. JOHNSON stated he has not reviewed this change at all. He deferred to one of the Assistant Attorney Generals working on this matter, agreeing that it is complicated.

MR. SEMMENS understood that this was an information-only item. MS. MILLHORN replied that it is informational; she checked with the Department of Law about who has the authority to make a plan change of this nature. She stated she would be happy to provide the ARMB with information from the Department of Law and from Deloitte. The intent is to conform to federal law that 50% of the benefit will automatically go to the spouse absent a spousal waiver. The Division wants to be consistent it its application.

MR. WILLIAMS suspected this item was information-only simply because if the plan does not conform to the IRC in this respect, the plan could be disqualified for 457 status. MR. TRIVETTE asked whether that is the case. MS. MILLHORN replied that Deloitte has indicated that the requirement of the law from January 1, 2002 going forward is that the spouse will receive 50% of the benefit, absent a waiver, but the Division is in the process of obtaining legal tax advice. In the past, the Division has had consulting tax advice. Deloitte said with respect to this law that there was not a plan qualification issue, whatever direction the change to the plan took. For all of the members who had beneficiary in place before 2001, the Division could choose to honor that earlier beneficiary form and pay someone other than the spouse. However, the Division wants consistency in its application, so it is proposing this amendment to the plan to treat all parties consistently.

MR. PIHL understood this requirement is also incorporated in ERISA. He asked if employers were not required by the law to contact each employee and require that they confirm their beneficiary as of that date. MS. MILLHORN replied that the plan is amended prospectively, but there was no requirement in that law that 457 plans to go back in time and treat the prior beneficiary forms on file differently. All of the forms and the notification process was changed on the date of enactment of that law.

COMMISSIONER NORDSTRAND understood the intent of the plan change is simply to achieve consistency. He explained that if there is a form prior to the effective date of the law that does not require a spousal waiver, but that requirement is in place after the effective date, a lawsuit could result in terms of relying upon the law. In order to protect the state, it is advisable to treat all plan members the same with regard to the requirement respecting a spousal waiver.

CHAIR SCHUBERT explained that her concern is with a divorce situation. For example there could be a situation of a beneficiary that had been in the system for 25 years, marries for two years, divorces, and there is a document that gives the spouse a 50% interest in the plan benefits that go back 25 years. She feared that the beneficiary could be upset with having only a 50% remaining benefit interest.

14. Employer Contribution Rate for FY07 and FY08 for Judicial Retirement System

MS. MILLHORN explained that a change has been recommended to the employer contribution rate for the Judicial Retirement System for FY07 and FY08. The authority associated with setting the employer contribution rate is retained by the Commissioner of Administration. A memorandum has been prepared for signature by the Commissioner of Administration based on the recommendation of Mercer Human Resource Consulting to set the rate at 37.37% for FY07 and FY08. The report prepared by Mercer entitled “State of Alaska, Judicial Retirement System, Actuarial Valuation Report as of June 30, 2004” had been provided to the ARMB for review.

MS. MILLHORN explained that action from the ARMB is requested on the National Guard and Naval Militia Retirement System contribution rate for FY07 and FY08. The valuation report prepared by Mercer indicates that as of June 30, 2004 the funding ratio is 67.8% compared with 59.0% in 2002. The recommendation for the contribution is $1,737,406 for FY07 and FY08. The authority to set this employer contribution rate was amended in AS 26.05.226(a) in accordance with SB141. The Division is recommending that ARMB take action on the FY07 and FY08 contribution rate. This rate was changed from $2 million in FY05 to FY06. The primary reason for the reduction in the employer contribution rate was a turnover rate higher than was projected that translated into a gain for the system of approximately $2.1 million.

MR. SEMMENS <u>moved to approve the employer contribution of $1,737,406 for FY07 and FY08 for the National Guard and Naval Militia Retirement System</u>. COMMISSIONER NORDSTRAND <u>seconded</u>.

MR. ROSES thought Trustee Harbo had asked what is the contribution rate for this plan and the written information indicates that plan members make no contribution at all. This is why no percentage contribution is shown. The actuary determines the amount that is sufficient to accumulate the assets. He remarked that, reviewing the rate over a period of years, at no time has this system been 100% funded. He asked why, if the goal is to be 100% funded, from 1998 to 2005 that has not been the goal. He asked if the recommendation from the Division would begin to close that funding gap. MS. MILLHORN replied that page 10 of the valuation report on indicates that in 1996 a supplemental contribution of $8 million was appropriated by the Legislature, indicating that when the funding ratio has gone down, there has been an additional appropriation to this fund.

MS. HARBO noted that the contribution rate was 67.8% in 2004 so it must be time for another contribution rate.

MR. PIHL noted that the contribution is approximately equal to benefits plus expenses. He realized there is some investment income, but he feared it would not be sufficient to achieve full funding. He remarked that a new actuary has been hired and a report will be produced in one year's time. He therefore questioned whether the rate should be set for one year and then use the information from the new actuary to set the rate for the following year. MS. MILLHORN indicated that the board could make this decision.

MR. ROSES had the same concern as Trustee Pihl that the actuary was asked a considerable number of questions and one could assume from those comments that the ARMB might be questioning some of the previous actuary's report. He was concerned with setting a rate for two years based on the work of that actuary, noting that this account is $6 million short and that rate would not close the funding gap.

MS. HARBO <u>moved to table this matter to the February 2006 ARMB meeting</u>. MR. TRIVETTE <u>seconded</u>.

By roll call vote, the motion FAILED with Trustees Roses, Trivette, and Harbo voting in favor and Trustees Corbus, Nordstrand, Pihl, Semmens, Williams, and Schubert dissenting.

MR. SEMMENS felt that he needs more information at this time in order to take action on this item. He asked what were the contributions for FY05 and FY06. MS. MILLHORN replied each was approximately $2 million.

CHAIR SCHUBERT understood that staff would be willing to accept a one-year allocation amount. MR. SEMMENS <u>amended his motion to pertain to the FY07 contribution only</u>. MS. HARBO <u>seconded</u>.

MR. PIHL preferred to see an approval of a $2,025,257 contribution, as was made in FY05 and FY06.

MR. BROOKS noted that the table on page 8 of the actuary's report shows that the normal costs are $700,000 and the recommended contribution amount represents a contribution to the unfunded liability of $1 million; the unfunded liability has an eight-year amortization horizon.

COMMISSIONER NORDSTRAND felt there was no reason to not approve $1.7 million each year for a two-year period in this program, given that there is no employee contribution or percentage of payroll contribution. At the end of the day, the contribution is a general fund appropriation. If after next year the actuarial evaluation reveals that a different contribution is advisable, a change could be made at that time.

MR. SEMMENS asked whose budget this goes against, and if the action of the ARMB is simply a recommendation. He found it interesting that this action sets the budget for a state department. COMMISSIONER NORDSTRAND understood that the Department of Law has determined the ARMB is responsible to set this rate.

MR. ROSES asked how this rate is set. COMMISSIONER NORDSTRAND replied that the amount is set by the actuary's calculations. In the absence of some other calculations, he felt there was no harm in adopting the amount of $1.7 million for two years and revisiting that amount later, if appropriate.

MR. WILLIAMS asked if there is a compelling budgetary process reason that a contribution rate should be set for two years versus one, given that the budget is reviewed annually, particularly when the ARMB will have new actuarial information and recommendations before the next budget cycle. COMMISSIONER NORDSTRAND understood this process is undertaken every two years. If there is new information from the new actuary, the rate for FY08 could be amended.

MR. TRIVETTE asked if it would be problematic to set the rate for two years and then raise the rate next year. MR. JOHNSON replied that setting this rate is new to this board. There is nothing in the law that suggests a problem in setting the rate for two years rather than one and there is nothing that prevents re-assessment of the rate in one year.

MR. SEMMENS asked if an actuarial valuation report as of June 30, 2005 is expected or is the Commissioner correct that the next actuarial report would be in two years. MS. MILLHORN replied that the schedule for this plan is every two years. The RFP and fees proposed by Buck were based on a two-year schedule for this plan. The fees for that work range between $12,000 and $15,000, so if another valuation is desired by the ARMB, that decision would carry that cost. MR. SEMMENS stated he would vote against his amendment based on this information. MR. WILLIAMS suggested the maker of the motion could withdraw the amendment. MR. SEMMENS felt, given the discussion and the fact there would not be another valuation, the motion without amendment is appropriate. *He withdrew his amendment*.

COMMISSIONER NORDSTRAND suggested that staff ascertain when the replication work by Buck will be completed.

By roll call vote, the motion PASSED unanimously.

15. Lowe & Invesco Incentive Fees

STEVE SIKES, State Investment Officer, explained that he would be discussing incentive fees for Lowe and Invesco, both of which are real estate separate account managers. After discussions with Mr. Johnson he believes the pension fund has the obligation to pay incentive fees to these managers. The compensation structure for these two managers is two-fold, one a base fee of 60 bp annually paid quarterly, and an incentive fee calculated very two to three years and is paid if the manager's performance exceeds pre-established hurdles contained in the contract. There is a hold back provision such that if the manager earns an incentive fee on a calculation date, 20% is withheld until the subsequent performance date and only if that manager earns an incentive fee. This serves to keep the advisors' motivation focused and provides protection against a decline in asset valuation. Last year the board decided to change its strategy from separate account to a fund-based strategy that invested in commingled funds. As part of that transition the board froze the allocations of these two managers, meaning they could not make any new investments and that their investments held must be sold. At this time, both advisors have sold all of their investments. This has resulted in two advisors with no assets that have not been terminated and there is a hold back provision to consider.

MR. SIKES explained the contract is silent on the situation of freezing allocation. Invesco's contract speaks to cases of termination and says the hold back provision would not apply in that case. In staff's opinion, the hold back provision is not applicable because both managers have sold all of their assets and therefore, there is no basis to evaluate their performance going forward. There are no plans to give these two separate account advisors new allocations. There is no longer a purpose for a hold back provision. Staff is recommending that the ARMB approve payment of incentive fees earned by Invesco and Lowe without hold back.

MR. SIKES clarified that the pension fund has two relationships with Lowe. The other one is through Lowe Hospitality Investment Partners and this action and issue has no effect on that relationship.

COMMISSIONER NORDSTRAND asked why the contract would not simply be terminated, which would resolve any ambiguity regarding the incentive fee situation. MR. BADER explained that in the case of Lowe there is a separate account agreement and Lowe asked to pursue a future strategy of commingled funds. At that time there were assets remaining in the separate account, so it would have been premature to terminate the separate account. It does no harm to terminate an account where no business is expected. These managers would likely not want to terminate until they receive their incentive fee. COMMISSIONER NORDSTRAND felt if there is ambiguity whether or not the fee is payable, termination would resolve that ambiguity. MR. SIKES understood the board was generally pleased with the performance of these two managers, but the structure of a separate account was no longer optimal. He remarked that terminating a manager may have some negative ramifications on the manager that perhaps the board was trying to avoid. MR. O'LEARY remarked that from an organizational perspective the account, not the manager, is being terminated. If the incentive fee were earned the manager would understandably want it. He suggested that this action be framed as closing an account, but continuing to work with the manager. MR. JOHNSON agreed that termination would resolve any legal issues.

CHAIR SCHUBERT asked if the motion would be to terminate the separate account mandates of Lowe and Invesco. MR. BADER replied in the affirmative.

COMMISSIONER NORDSTRAND moved to approve payment of the incentive fees subject to termination of the separate accounts of Lowe and Invesco. MR. ROSES seconded.

MR. SIKES noted that the Lowe contract is silent with respect to the hold back provision, while Invesco's speaks to that provision.

By roll call vote, the motion passed unanimously.

16. Private Equity Evaluation

For more information on this presentation, please refer to the document entitled "AMRB Private Equity Portfolio Review and Performance Analysis," dated November 29, 2005 and kept on file at the ARM Board offices.

MICHAEL O'LEARY with CAI explained that annually CAI does a special performance analysis of private equity investment. He suggested that time be allocated at a future meeting for education in private equity.

MR. O'LEARY began his presentation with a review of the timeline of the System's involvement in private equity. The ASPIB initiated a 3% target and hired Abbott as an oversight manager, investing in limited partnerships that invest in private equity. In 2001 the target allocation was raised to 6% and a second oversight manager, Pathway, was hired. Early in 2005 ASPIB hired two corporate governance managers: Relational, which invests exclusively in publicly traded securities, as corporate governance manager and Blum Capital, which invests in both publicly traded securities through a fund and in a combination of publicly traded and direct investments through another fund.

MR. O'LEARY explained that the type of private equity in which institutional investors invest is higher risk, higher return, including venture capital, buyout funds and special situation funds. Access to pre-eminent general partners is the challenge and that is why an oversight manager is hired. General partners come to market with a new fund approximately every 4 to 5 years. Abbott or Capital makes a commitment to invest in a partnership and the partnership draws down funds on an as-needed basis; it could take up to 8 years to fully invest the commitment. As drawdowns are taken for the later investments, returns may be realized on earlier investments. As a result, it could be 6 to 7 years before a private equity program is in place. Each year staff has to develop a budget of how much money they would like the oversight managers to commit and those managers may or may not be able to place the available commitment.

MR. O'LEARY reviewed a graphic representation of private equity fund commitments from 1991 through June 2005.

Abbott began in early 1998 and made initial investments that had spectacular returns. The Systems benefited from dot-com venture capital investments. Unfortunately, that may have prompted acceleration in the allocation target of the Systems from 3% to 6%. To date, Abbott has made commitments of $949 million and paid in $630 million, leaving $320 uncalled. To date $293 million has been distributed and the net carrying value of paid in less distributions is $418 million, for a total value of $712 million. The internal rate of return (IRR) since inception has been 4.58%. The distributions as a percent of paid-in capital is 47%, the net carrying value as a percent of paid in capital is 66%, and the total relative to paid in capital is 113%.

Pathway began in mid-2001 and has committed $444 million, only $136 million of which has been paid in, leaving $308 uncalled. Distributions to date have been $47 million and the net carrying value is $126.7 million, for a total value of $174 million. Their IRR is 31.1%. This figure is deceptive and is the result of initial high distributions resulting from an initial investment that was relatively small. Combining Abbott and Pathway, the net carrying value in traditional private equity is $545 million.

MR. O'LEARY explained these managers are evaluated based on how the funds they picked in a particular year (class year) have done relative to other funds that were open in that class year. Abbott's investments in the last four years should not be given too much weight, but are more informational in nature. Abbott's vintage year 1998 return is 7.4% even with a bear market and the demise of dot-com. Their investments in 1999 have had a poor return. Those made in 2000 have had strong relative returns, as have those made in 2001. MR. O'LEARY suggested that 2002 and 2003 should not be given significance because those funds are young.

Pathway tends to emphasize buyout firms more than venture capital. A distressed fund did well in this portfolio. The pattern of the returns looks very encouraging.

MR. O'LEARY noted the presentation identifies each manager's IRR by strategy. He noted these figures are not comparable because each manager was funded during a different period. Aggregated, the System's private equity is very well diversified with the largest category being buyout, followed by special situations, and then venture. This diversification is consistent with the System's policy.

MR. TRIVETTE asked for a definition of "special situation." MR. O'LEARY gave the example of First Reserve, which is an energy-focused partnership, as well as distressed debt. There could also be a mixed strategy or mezzanine financing. The expectation is that private equity investment, if done well, should return a minimum of 25% more than the return achievable in the public equity market and probably closer to a 50% premium.

MR. O'LEARY continued his presentation. He stated the Blum portfolio was initiated in April 2005. There are two partnership investments: Stinson A and Strategic Partners III. This manager's strategy is to take meaningful positions in under performing companies and be a catalyst for change. Stinson A has 12 investments and Strategic Partners III has 13 investments; 5 are identified as cross-holdings in the partnerships.

MR. BROOKS asked if this investment method is comparable to what Brandes does in the international market. MR. O'LEARY replied that Brandes deals exclusively with publicly traded equity; they are a more traditional value manager. They might express their views to management, but they do not purport to influence management. Blum, on the other hand, is actively involved with management. MR. BROOKS asked if both managers target under performing or under valued investments. MR. O'LEARY explained that Blum's investments are much more targeted and involve private equity investments.

COMMISSIONER CORBUS asked what is the difference between Blum and Relational. MR. O'LEARY replied that Relational deals with larger cap companies; they would tend to not realistically have control by themselves because of the scale of the company in which they are investing, whereas Blum could theoretically establish a control position.

MR. O'LEARY noted that a total of $100 million has been committed to Blum. Their performance is compared to an S&P 500 IRR as opposed to an S&P time weighted return. After one quarter, this manager has had a positive return.

MR. O'LEARY reiterated his suggestion that this topic be put on an agenda in the near-term so the ARMB can become more educated about private equity investment. He indicated he is very pleased with both the Abbott and Pathway portfolios. They have made such good progress that the program is reaching the stage at which the System has to be mindful of the amount of money each manager is committing going ahead so there is not an over allocation to private equity.

LUNCH BREAK 12:05 p.m. to 1:18 p.m.

17. Board Report to Legislature

GARY BADER, Chief Investment Officer, explained the legislation that created the ARMB requires that the ARMB report to the Legislature either 120 days after the members are appointed or 15 days after the beginning of the legislative session following the enactment of the law. The report is therefore due no later than January 25, 2006. To ensure there is sufficient time to complete this report, staff believes it is important that the ARMB consider the structure and content of the report. Staff has prepared an outline of a possible report format to use as a starting point for the ARMB. Part of the report will have to communicate that some of the things the Legislature has desired will have to be reported in April. The purpose of putting this information and the mission statement before the Board is to initiate discussions regarding items required in the legislation that created the ARMB.

MR. BADER briefly reviewed the outline of the ARMB report to the Legislature put forward by staff. He explained that action is needed to begin the work to prepare this report. He suggested that the ARMB give direction whether it wants to utilize a committee structure to do this work, work as a committee of the whole, or have staff draft the report.

COMMISSIONER NORDSTRAND felt the outline presented by staff was an excellent starting point. He suggested that a committee of the ARMB and staff might meet to discuss if there are other areas that should be covered in the report. He indicated he would serve on this committee. CHAIR SCHUBERT agreed to serve on the committee. MR. TRIVETTE also volunteered to serve on the committee and complimented staff for the outline they had prepared.

MS. HARBO felt the outline proposed was a good start. She suggested that section II.B, "Funded Status of Defined Benefit Plans" include the Military system funded status with 10 years of history. COMMISSIONER NORDSTRAND believed the actuary report has close to 10 years of contribution rates and funding recommendations.

MR. SEMMENS agreed to serve on the committee.

MR. BADER recommended the Chair appoint a chair of the committee and that a meeting date be established. CHAIR SCHUBERT suggested working with staff to set the date and appointed Trustee Semmens to chair. She noted that Trustee Corbus is also welcome to serve on the committee, should his work schedule permit.

MR. PIHL thought a committee structure was appropriate, but it would be well to give Mr. Bader the authority to move forward. COMMISSIONER NORDSTRAND volunteered that Ms. Millhorn to work with Mr. Bader to develop a more expanded draft outline before the first meeting of the committee.

CHAIR SCHUBERT asked whether action is required to establish the committee. MR. BADER felt that the ARMB had voiced its desires and staff would move forward based on that. CHAIR SCHUBERT noted that time is short, particularly given the holiday.

MR. WILLIAMS stated his experience with Roberts Rules is that the chair will define the members of a committee, its scope, and deliverables. MR. BADER stated that at its last meeting the ARMB adopted the policies that were in place for the ASPIB and Roberts Rules are therefore the standard for this board.

MS. HARBO moved that the ARMB ratify the appointment of the Report to the Legislature Committee. MR. ROSES seconded.

There being no objection, the motion was unanimously approved.

18. Board Mission Statement – Update Policy Manual

GARY BADER explained that this mission statement is simply meant to initiate discussion. He thought the board-appointed committee for the Report to the Legislature would benefit from identification of a mission statement. He stated he has been told that the statement could be improved by adding things such as addressing unfunded liability and monitoring the liabilities of the System. Either the ARMB could discuss this today or he would entertain discussions and suggestions from Ms. Millhorn and others, which he could present to the Report to the Legislature Committee and then to the ARMB at its next meeting.

COMMISSIONER NORDSTRAND asked that this matter be sent to the Report to the Legislature Committee.

MR. ROSES noted that the draft mission statement does not address the liabilities side of the equation.

MR. TRIVETTE suggested sending any ideas related to the ARMB's mission statement to Mr. Bader.

VIII. UNFINISHED BUSINESS

1. Action Items

JUDY HALL stated the ARMB trustees' packets contain an Action Item list with one action item. She explained this list ensures that items of interest to the ARMB are addressed.

2. Disclosure Report

JUDY HALL reported that a disclosure report is contained in trustees' packets. Some of the trustees might not be aware of this requirement because trustee orientation was not completed, so Mr. Johnson will explain the reporting requirements in more detail. MR. JOHNSON stated there are specific disclosure issues of which the ARMB must be aware, one that is specific to the ARMB having to do with disclosures of particular investments. Trustees are required to disclose investments in order to ensure there are no conflicts of interest. The ASPIB had adopted a regulation that speaks to issues that constitute a genuine conflict and it describes a generally high level of ownership in a fund or a security that parallels the SEC rules. The other issue requires disclosure of investments so that the record shows there is no conflict. From time to time in the past there were situations where ASPIB members recused themselves from matters, in particular where a trustee had a relationship with a company that was the target of litigation.

The ARMB is also bound by the Executive Ethics Act and a video explaining the requirements of that act has been produced by the Attorney General's Office. This law includes a provision that the designated supervisor of a board, in this case the chair, is obligated to submit a report within 45 days of the end of each quarter disclosing any conflicts. The Attorney General's Office view of best practice is to have a written statement from the chair stating there have been no reported ethics issued. This can be done using a prepared document. The chair would ask at a particular meeting prior to the end of a quarter if there are disclosable ethics issues and if so, trustees should so state. The chair would sign this document and submit it to Ms. Hall to transmit to the Attorney General's Office. He recommended the ARMB adopt this practice as a best practice to comply with the Executive Ethics Act quarterly reporting requirement.

The ARMB also has a unique reporting requirement with respect to unions. The federal law requires reports be filed if certain instances arise. The law reads that there is no requirement that Trustee Williams fill out an LM30 form or for the State to file an LM10 form on his behalf.

MR. JOHNSON explained his report is intended to be a reminder to the ARMB of the requirements contained in various aspects of the federal code. He added there is also a Department of Revenue internal disclosure requirement. MR. BADER explained there is an internal policy within the Department of Revenue, since it actively invests in REITs, that the CIO clear any purchase in a REIT by the investment staff or others who would have knowledge. He did not believe the ARMB would have any requirement in this regard because staff would not be informing the ARMB Trustees of individual investments that would be made.

MR. JOHNSON noted that trustees should report any investment change in their self-directed SBS or Deferred Compensation accounts.

COMMISSIONER NORDSTRAND asked if disclosure is made using an APOC form or a special form particular to the ARMB. MR. JOHNSON replied that the form is included in the ARMB packet. COMMISSIONER NORDSTRAND noted the APFC provides a list of managers and their funds and investments and disclosures are required of any trustee's investments in those particular funds or investments. COMMISSIONER CORBUS noted that the APFC also requires that the number of shares purchased be reported, whereas for ASPIB the reporting was simply that some stock had been purchased. COMMISSIONER NORDSTRAND wondered whether the genesis of the disclosure requirements is the same legislation. COMMISSIONER CORBUS stated there is a question why all reporting could not be done the same way; this question was raised at the APFC and the attorneys said there had to be separate reporting.

MR. TRIVETTE noted that the APOC form is different than the ARMB form.

MR. WILLIAMS asked if the ARMB requires that he provide a separate disclosure apart from what he discloses to APOC. MR. JOHNSON replied in the affirmative.

MR. SEMMENS asked for an explanation of the procedure for disclosure. MR. BADER explained that a disclosure form must be prepared whenever there is a purchase of sale of equities or bonds. The form is faxed to Ms. Hall, it is taken to Mr. Boutin for verification, and it is put on file. At the next ARMB meeting a disclosure report is made that indicates a particular trustee bought a particular security, without defining the security.

COMMISSIONER NORDSTRAND asked whether a quarterly report is required on a mutual fund where the dividend essentially buys more shares. MR. BADER stated it has always been his approach that an additional disclosure is not required in this situation.

MR. WILLIAMS felt this discussion brings up the issue that this board has not spent much time going over its policies and procedures in depth. He hoped that time could be allotted at the January 2006 meeting for more explicit trustee orientation.

MS. MILLHORN asked that Mr. Bader clarify who is included in the reference to "staff" that must make disclosures. MR. BADER believed that anyone who is attending the ARMB meetings and has the opportunity to understand the strategies being used by investment managers should do this reporting. MR. JOHNSON felt this could be done, but the direction of the law has been the ASPIB/ARMB and its staff and the Department of Revenue is by law the staff of the ARMB. COMMISSIONER NORDSTRAND thought it might be wise to identify the staff that has to report in order to protect staff. MR. JOHNSON agreed with this suggestion. He added that at some point in time regulations must be addressed by the ARMB to implement SB141 and to consider which of the ASPIB regulations might be carried forward.

MR. SEMMENS asked if the requirement to report investment transactions extends to any investment over which a trustee might have control. MR. BADER believed this requirement includes IRA accounts and accounts over which a trustee exercises control, such as those of children or a spouse. MR. WILLIAMS asked if this would extend to the trust for which he is a trustee. COMMISSIONER CORBUS stated he found himself in this position 10 years ago and the commissioner at that time issued an opinion that a report would not have to be done funds for which one is a trustee, unless one is a beneficiary.

MR. PIHL asked what is required in the situation of an IRA that has been placed with a bank that the bank has invested in five options and those managers buy and sell almost daily and the trustee is not aware what is bought or sold. MR. BADER felt this was analogous to a mutual fund and he understood that reporting who manages the fund is adequate. MR. PIHL noted that is done in the APOC report. MR. WILLIAMS noted that the ARMB requires a separate report, however.

MR. SEMMENS stated he filed a report to APOC but received no confirmation that the report was received. He asked if there is a further requirement to report to APOC. COMMISSIONER NORDSTRAND replied that there are different reporting requirements to different entities and the ARMB requires a separate report. The detail in the ARMB report goes more to specific investments and investment managers and whether there is a direct conflict of interest. He would like there to be symbiosis with what the APFC does in order to reduce the number of forms to file. MR. SEMMENS stated if he is required to do this report, he would like to be informed. MR. BADER made the distinction that there is a requirement to file a report with APOC and a copy of that report is also given to Ms. Hall. The APOC report is required annually, so stock that is bought tomorrow would not be reported until the next APOC reporting period. The ARMB requirement is specific to each purchase/sale. MR. SEMMENS asked which ARMB form would be used, noting that there are two in the packet. MR. BADER replied that either form in the packet is acceptable.

COMMISSIONER NORDSTRAND offered caution regarding a situation where a trustee is unaware of transactions taking place on their behalf. There are complicated legal issues associated with whether or not a person actually directs those transactions, can direct those transactions, is aware of the transactions, and thus has a reporting obligation. He thought it might be appropriate to talk with the Department of Law or Mr. Johnson regarding what oversight exists in this circumstance.

3. Legal Report

ROB JOHNSON had no additional legal report.

IX. NEW BUSINESS

MR. TRIVETTE discussed information on the KPMG deferred prosecution. He noted at the ASPIB September meeting one of the ASPIB members asked about KPMG being charged with criminal activity. He made contact with the appropriate people, via Ms. Taylor, and has received a 38-page document detailing this matter. He summarized that the matter dealt with the tax division of KPMG, not the auditing division that works with the ARMB. At the same time, the statement of facts, which comprises 10 pages, is concerning. From 1996 through 2002 the firm assisted wealthy individuals to evade US individual income taxes on billions in capital gains by developing, promoting, and implementing unregistered and fraudulent tax shelters. Once the IRS became aware of these activities, KPMG impeded the investigation by failing to provide certain records. This activity took place at the highest levels of the corporation. The actual losses were $11.2 billion and the fees KPMG made on these fraudulent transactions were $115 million.

MR. TRIVETTE stated it is also understood that advisors to the firm made it clear the practice was illegal, yet the practice continued. The US Senate began its own investigation and in essence the same thing happened at the Senate level as at the IRS. KPMG was summoned and their records were summoned and they intentionally omitted some information. The Senate held hearings over a period of approximately 1.25 years. Through November 2003, after the Senate concluded its hearings and indictments were brought, KPMG decided to cooperate and from that point forward they fully cooperated. People were terminated and other appropriate actions were taken. KPMG ended up paying $456 million in fines and fees back to the US government. They are on deferred prosecution, which is common when a defendant does not have a prior record. They are required to meet certain conditions within a particular period of time and there is no criminal conviction. MR. TRIVETTE offered that, should any trustee want a copy of the information related to this issue, it could be made available.

MR. WILLIAMS did not recall any discussion in the Chair Report about the proposed committee list in terms of setting scope, authority, or deliverables, nor was there approval of the committees. He stated would like the ARMB to entertain the scope and authority of these committees. CHAIR SCHUBERT asked to delay action on formal committee structure and dealt with that at the next ARMB meeting.

MR. ROSES noted that the ARMB has adopted a motion that it would hire an actuary. He asked if the actuary that was hired is working for the Department of Revenue, Department of Administration or the ARMB. COMMISSIONER NORDSTRAND responded that the Department of Administration employs the actuary. The Department of Administration has executed a contract with the actuary and they work for the Department of Administration. MR. ROSES confirmed that Mr. Nordstrand as Commissioner of Administration had signed the contract. He asked if the ARMB’s signature is on the contract or is it necessary. COMMISSIONER NORDSTRAND did not believe this would be necessary. The powers of the ARMB require that the ARMB will coordinate with the administrator in connection with the primary actuary, but in fact the reviewing actuary will report every four years. The language of the statute is that the ARMB contracts with the reviewing actuary and it was his opinion that the ARMB would contract with the reviewing actuary and the Department of Administration would contract with the primary actuary in consultation and coordination with the ARMB.

MR. ROSES moved that the chair of the ARMB sign a contract with the actuarial consultants so the ARMB has direct access to the actuary as it works through actuarially-related issues. MR. TRIVETTE seconded.

MS. HARBO felt that access to the actuary is important for the ARMB, noting that when the actuary spoke this morning there were a number of questions.

MR. WILLIAMS asked whether the contract with the primary actuary allows the ARMB access as it is written, begging the question of whether signature by the ARMB is needed. COMMISSIONER NORDSTRAND replied that the contract is with Division of Retirement and Benefits, which will pay the bill. The statute obligates the Department of Administration and the actuary to coordinate with the ARMB to provide any and all information; there would be complete access. He stated that there be complete access to any information the ARMB desires. The contract is simply a legal relationship between the Department of Administration and the actuary to provide services. He did not think the ARMB is the appropriate entity to enter into a contract for these services given that payment of the actuary is coming from the Division of Retirement and Benefits budget. The ARMB is seated within the Department of Revenue, not the Department of Administration. He stated the lines were clear to him, but there is no issue in terms of access to the actuary.

MR. PIHL opposed the motion.

MR. JOHNSON thought the issue is access to the actuary and the ability of the ARMB to utilize the services of the actuary. He agreed that the Department of Administration has authority to enter into a contract with the actuary. He felt the key issue is that the contract is valid and the ARMB has access to the actuary.

MR. SEMMENS asked what would happen if the ARMB wants analysis that is outside the scope of the initial contract and that analysis would affect the Division of Retirement and Benefits budget because of cost. COMMISSIONER NORDSTRAND replied that the Division of Retirement and Benefits has to be the master of its own budget at some point. There have been requests from legislators and others for actuarial information that carried a cost that was not within the budget. If the funding is not available, the request cannot be granted. He suggested that if there is a desire for important information that has a large associated cost there would be the opportunity to discuss funding. He reiterated that the Department of Administration would be cooperative in all requests for information.

MR. TRIVETTE noted that the previous boards have been criticized because of what the actuary said. He wanted to ensure that there is communication between the ARMB and actuary, which has begun. He felt this dialogue should continue, particularly through the initial year of the ARMB's operation. He noted that the prior boards sometimes received the actuary report the day before a meeting, which did not sufficient time for adequate review. He stated that, if there is guaranteed access to the actuary, he would withdraw his second to the motion.

MR. SEMMENS explained that he would not want to be adversarial to team members, but he feels it is important for the ARMB to be able to ask questions of the actuary without having someone saying that the ARMB does not need that question answered. He stated that if there is commitment from the Department of Administration that will not happen, at least without the discourse Trustee Nordstrand described, he could accept that.

MR. ROSES stated he made the motion for the purposes of discussion, so he would *withdraw the motion*.

COMMISSIONER NORDSTRAND committed to absolutely provide any information the actuary has and that there be no filtering of information. There will be direct access for the ARMB. He felt there should be some coordination, for instance ARMB trustees should not ask questions directly of the actuary, but perhaps instead go through the ARMB Chair. The ARMB Chair would in turn inform the Division of Retirement and Benefits of questions that are outside of the contract. The Division would find out the cost to answer the questions and decide if it is or is not a priority and if there is or is not available funding. He reiterated that he is entirely open to discourse, but from a budgetary standpoint the Department of Administration has to have some kind of control over the budget.

MS. HARBO thought there was something in the legislation that created the ARMB that discussed a second actuary, not only the reviewing actuary every four years. She asked if the second actuary is intended to conduct an annual review of the primary actuary. COMMISSIONER NORDSTRAND thought an experience study is done annually. MS. MILLHORN replied that the experience study is done every four years. COMMISSIONER NORDSTRAND stated the legislation says the ARMB will coordinate with the administrator on hiring a primary actuary. There is another requirement in the legislation that the ARMB contract an actuary directly to review what the primary actuary did, MS. HARBO felt that so long as it is clear the ARMB has access to the primary actuary, her concern is addressed.

MR. JOHNSON stated the requirement for second actuary is found under Section 8 and Section 9. "Review actuarial assumptions prepared and certified by the American Academy of Actuaries and conduct experience analyses of the retirement systems not less than once every four years." It further states, "except for health cost assumptions, which shall be reviewed annually; the results of all actuarial assumptions prepared under this paragraph shall be reviewed and certified by a second member of the American Academy of Actuaries before presentation to the board." This clearly says the second member of the American Academy of Actuaries would review all the actuarial assumptions. The experience analysis is to be done every four years and health cost assumptions shall be reviewed annually. He read this to require a second actuary that will conduct an annual review of at least health cost assumptions and more often in discussions of overall actuarial assumptions. CHAIR SCHUBERT asked if the ARMB would hire that actuary directly. MR. TRIVETTE believed this was the case.

CHAIR SCHUBERT noted that Buck Consultants mentioned they were going to reconstruct the Mercer assumptions and asked who pays for that and why Mercer could not simply provide what they did electronically. MS. MILLHORN stated Buck has asked the Division to provide them with the data that underlies the June 30, 2004 valuation. They will use that existing data to replicate the actuarial analysis. That is part of the RFP for which the Department of Administration pays.

MR. PIHL understood that the Department of Administration pays for the actuary's contract but those monies come from the pension funds. COMMISSIONER NORDSTRAND indicated this is correct.

X. OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD

MR. ROSES asked for information on the 26th national Callan Conference to be held in San Francisco. MR. O'LEARY explained that CAI runs one national conference annually and several regional half-day conferences that are focused on a particular topic. CAI also has a national conference focused specifically on defined contribution plans. The conference about which Trustee Roses inquires is typically attended by 500 to 600 people and CAI has a substantial budget to get speakers. Many of CAI's clients value this conference not only for the program content, but also for the opportunity to network with peers from other funds. This conference is in San Francisco, providing an opportunity for ARMB trustees to visit Tukman and RCM, two of its managers. In the past there have been one to two or up to eight or nine board and staff representatives from the predecessor board to the ARMB. There are no registration costs, but attendees are responsible for transportation and lodging; meals are provided during the course of the conference.

COMMISSIONER CORBUS commented that he attended these conferences in the past and he had the opportunity to meet Mr. Markowitz and Mr. Sharpe, two individuals who have greatly influenced investing. He believed these conferences offer a good experience.

MR. ROSES stated he has been investigating healthcare cost items and wished to report that Kim Anderson and Laurie Lewis with AMG have devised a computer program that inputs data reported by doctors of prescriptions, diagnoses, etc. into the system and are able to ferret out any fraud. They have a good track record in this regard. He began investigating this because his wife's uncle is engaged to someone who was in the health insurance provider business and this is her daughter. The work involves monitoring physicians and the protocol for the care related to a particular diagnosis. He stated he would pass this information to the Retiree Healthcare Cost Containment Committee.

XI. PUBLIC/MEMBER COMMENTS

CAROL EATON with RPEA stated she had reviewed the outline for the ARMB's Report to the Legislature and noticed that the funding goals under IV.A Funding Goals of the Board is 100% funded ratio of assets to liabilities. She understood that SB141 calls for a 105% level of funding in order for cost of living increases to be granted, so perhaps it would be appropriate to conform to that provision.

KRISTIN ERCHINGER, Finance Director for the City of Seward, thanked the ARMB for its work. She urged the ARMB to consider making the issue of addressing unfunded liabilities one of its priorities. Her concern as a finance officer is that the rising interest rate environment will reduce the alternatives for covering the unfunded liability. She also asked that the ARMB consider the issue of pension obligation bonds. She explained that local governments in the State of Alaska do not have the authority to issue pension obligation bonds, therefore, the local governments have no opportunity to address their unfunded liabilities. She asked that the ARMB support the concept of creation of a mechanism for funding pension obligation bonds, a mechanism by which each local government to make the decision whether or not to participate in a statewide pension obligation bond. She noted that she is the immediate past president of the Alaska Government Finance Officers Association and this issue has been on the Association's agenda for two years. The Association has taken action in the last two years to support this legislation and asks that the ARMB do the same.

XII. INVESTMENT ADVISORY COUNCIL COMMENTS

DR. MITCHELL felt this board has employed good firms with broad research capacity and sensible investment processes. He stated when a manager presents to the board he first looks to see if the presentation explains convincingly why they did or did not do well in terms of performance. He then looks to see if the presentation is consistent with the manager's portfolio. He thirdly looks to the manager's responses to questions from the board, the staff and the IAC. Fourthly, he looks for some kind of body language and whether the representative(s) can be trusted and believe what s/he is saying.

Applying these four criteria, DR. MITCHELL felt BlackRock, Brandes and Lazard performed very well. However, he was troubled by TCW in that the firm presents itself as investors who look for underlying value irrespective of the macro environment, but most of the presentation was about how the macro environment, the Federal Reserve action on interest rates, will determine the performance of the portfolio. He also noted that some of the responses to questions were not head-on. He stated that he is comfortable with this manager, but would suggest that they be monitored.

Regarding the draft mission statement DR. MITCHELL stated he has for close to 10 years been advocating a change in the definition of "best financial performance" and he complimented the staff for providing a proper definition.

DR. JENNINGS stated TCW is on the ARMB Watch List and their under performance of 5% to 8% over the last three and one-half years equates to $100 million of under performance. He felt this merits some consideration. He noted that a manager review meeting was held in Denver with Mr. Bader, CAI and members of the IAC. He advocated that, as the ARMB considers having committees and worksessions, in the trustees' roles as governing fiduciaries, committees are a good mechanism to allow technical questions to be asked. He noted that historically in February the Alternative Investments Committee met with private equity managers; it is this kind of event when the committee can get more detailed information and ask questions in a format that is less formal.

MR. O'BRIEN had no additional comment.

XIII. TRUSTEE COMMENTS

COMMISSIONER NORDSTRAND felt there is an opportunity for the ARMB to do what the APFC and Department of Revenue have done to use this bully pulpit to facilitate internships for Alaska university students with money managers. He was aware the Commissioner of Commerce is actively working to bring more financial service organizations to Alaska. He suggested talking with the APFC, which has an organized process of encouraging interns both at the APFC and with their managers.

MS. HARBO thanked staff for two good meetings in October and November. She felt the ARMB has accomplished much during those meetings. She appreciated the mutual respect that trustees show for each other and for staff. She thanked the Department of Revenue and Department of Administration for being patient when she asks for information.

MR. PIHL stated he was happy to see the Governor’s announcement of a plan that he hoped would fund the 5% increase in contribution rates to the System. He felt the State should save so there is not a snowball effect in terms of unfunded liability. He hoped to put on the agenda for the next meeting an ongoing study into the feasibility of investing in the Alaska gas pipeline. He personally believed that there is an opportunity to invest Alaska Permanent Fund and pension fund money into that pipeline. He believed the return on this investment could potentially be high. He indicated that the State projects that even at a $5 per unit cost of natural gas, the profit is $25 billion over a 30-year period. He suggested that, if anyone is worried about whether this is an appropriate investment for the pension fund and the Permanent Fund, the State should be in a position to guarantee it.

MR. SEMMENS requested that the administration keep the ARMB informed of any legislation that affects the System. He found himself ignorant of things he had great intention of keeping up with in the legislature; in reality it is extremely difficult to keep up with all legislation. He also hoped the ARMB would be willing to make its opinion known on specific legislation. COMMISSIONER NORDSTRAND stated there is a legislative liaison in the Department of Revenue that can provide this type of report periodically. He stated there are bills pending currently that would impact the System. MS. HARBO noted that for the last two or three years the joint PERS and TRS Boards sent letters to legislators asking that legislation to enhance benefits not be adopted.

MR. TRIVETTE reminded the Trustees of the Ways & Means Committee meeting scheduled for December 7, 2005 from 1:30 p.m. to 4:30 p.m. MR. SEMMENS indicated he would be making a formal presentation at that meeting, primarily from the perspective of a local government.

XIV. FUTURE AGENDA ITEMS

MR. BADER noted that the outline of the Report to the Legislature indicates the ARMB would study pension obligation bonds. This can be accelerated, should the trustees so desire. MR. SEMMENS stated he heard a presentation on this subject at the Alaska Finance Officers Association meeting and he felt it is something about which the full board should, at some point, be aware. He noted that it is a fairly complicated topic. He agreed the ARMB should, at some time, review this topic and that it should be listed as one of the things the Legislature should consider. MR. BADER thought the Report to the Legislature Committee would ultimately make a recommendation to the ARMB and this issue will likely arise early in the legislative session. He stated something would be scheduled before the full ARMB so that all trustees are aware of the issues before the legislative session. MR. PIHL noted that is part of the Report to the Legislature due April 15, 2005.

XV. ADJOURNMENT

MS. HARBO moved to adjourn the meeting of the ARM Board. MR. ROSES seconded.

There being no objection, the motion passed unanimously.

THERE BEING NO FURTHER BUSINESS TO COME BEFORE THE BOARD, THE ARMB MEETING ADJOURNED AT 2:50 PM ON November 30, 2005.

Chairman of the Board of Trustees
Alaska Retirement Management Board

ATTEST:
Gayle W. Harbo
Corporate Secretary

Note: The summary minutes are extracted from tape recordings of the meeting and are prepared by outside contractors. For in-depth discussion and presentations, please refer to tapes of the meeting on file at the ARM Bard offices.

WORDSMITH
Kimberly D. Stalder
Anchorage, Alaska