

**ALASKA RETIREMENT MANAGEMENT BOARD
MEETING**

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

MINUTES OF
June 14-15, 2006

Wednesday, June 14, 2006

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
Scott Nordstrand
Mike Williams
Bill Corbus

Consultants Present

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

IAC Members Present

Tim O'Brien
William Jennings
Jerrold Mitchell

Department of Revenue Staff

Tom Boutin, Deputy Commissioner, Department of Revenue
Gary Bader, Chief Investment Officer
Zachary Hanna, Investment Officer
Steve Sikes, Investment Officer
Bob Mitchell, Investment Officer

Susan Taylor, Comptroller, Treasury Division, Department of Revenue
Judy Hall, ARMB Liaison Officer, Department of Revenue

Department of Administration Staff

Melanie Millhorn, Deputy Commissioner, Department of Administration
Traci Carpenter, Director, 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

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

MR. BADER asked that the review of Townsend, agenda item 15.b, be changed to “Discussion and Table.”

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

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES – None

VI. APPROVAL OF MINUTES

MS. HARBO moved to approve the minutes of March 23-24, 2006 and April 10, 2006. MR. WILLIAMS seconded.

MS. HARBO asked whether on page 17 of the March 23-24, 2006 minutes, under Mr. Slishinsky’s report, the cost of living adjustments (COLA) portion might be clearer if it contained what is in the materials about COLA. For those aged 60 years and less than 65 years the COLA is 50% of the Anchorage CPI. For those over 65 years it is 75% of the Anchorage CPI. She recommended tying the COLA information in the minutes to the Anchorage CPI rather than to a specific percentage amount.

COMMISSIONER NORDSTRAND felt that if this is what Mr. Slishinsky said, that should be in the minutes, even if it is not entirely clear. MS. HARBO suggested that the actuary be asked to clarify his remarks during future presentations.

There being no objection, the motion was unanimously approved.

VI. REPORTS

1. Chair Report

CHAIR SCHUBERT stated the New York conference was a success. She indicated that she is in the process of writing thank you letters to those who presented at the conference. She congratulated Ms. Millhorn for her promotion to Deputy Commissioner of the Department of Administration and Ms. Carpenter for her promotion to the Director of the Division of Retirement and Benefits. CHAIR SCHUBERT stated she would need to leave the meeting at 11:30 a.m. to do a presentation to the Bar Association during lunch.

2. CIO Report

GARY BADER first reviewed a letter to Buck Consulting responding to four questions put to them by the ARMB. In the April 26, 2006 letter from Mr. Slishinsky to the Chair he said "As you can see, with the current contribution rate of 16.77% and 21% for TRS and a 5% increase for FY07, the assets deplete very quickly." Tables are included to demonstrate asset depletion.

MR. BADER reported that a number of instruments have been signed by staff under delegation from the prior ASPIB and the ARMB. Mr. Johnson was asked to review the fact that staff members had signed these documents. It was Mr. Johnson's suggestion that it was appropriate for staff members to sign those, but it would be good practice to inform the Board of contracts signed by the staff. These contracts are investments approved by the Board. Staff wished to advise the Board of these contract signatures; the documents authorizing staff's action are also included.

MR. BADER noted that from time to time some asset classes perform very well while others under perform. The Board has set target allocations for each asset class. From time to time the Board has authorized the CIO to rebalance to stay within the allocation bands. To that end, \$50 million was transferred from Brandes International to the internal fixed income fund and \$27 million was transferred from SSGA's S&P 500 fund to the internal fixed income fund.

MR. BADER reported that a communication was received from Brandes on their view of the commission recapture program. It is consistent with the Board's requests. Best execution is the controlling concern.

MR. BADER reviewed a communication from Capital Guardian disclosing the use of investment consultants. They state "During our year ended December 31, 2005, \$146,625 was paid by Capital Guardian to Callan." He noted that those disclosures also come from Callan to the Board.

MR. BADER indicated staff is recommending that Lowe Enterprises be placed on the Watch List. The ARMB has committed \$50 million to the Lowe Hospitality Investment Fund. As of May 15, 2006, the ARMB had invested approximately \$30 million with that fund. They have had significant staff turnover, which is a subjective criteria to place a manager on the Watch List. This turnover includes Bernie Segal, the head of hotel acquisitions, Chad Christianson, the portfolio manager, and Cathy Ebert, the client relations contact. This investment is under review by Townsend, the ARMB's investment consultant, and Mr. Sikes has expressed a concern to the president of Lowe about the turnover and its potential impacts on the ARMB investment. This is

a closed-end fund and the ARMB does not have the ability to sell the shares, except at a large discount. Staff believes that placing this manager on the Watch List is warranted.

MS. HARBO moved to place Lowe on the Watch List. MR. SEMMENS seconded.

There being no objection, the motion PASSED unanimously.

MR. BADER noted that the Lazard Asset Management Global fund underperformance meets the quantitative criteria for placement on the Watch List. Staff has reviewed the fund's returns over a three-year period. The most recent performance data has been very favorable. MR. BADER noted that while the quantitative criteria would merit placing this manager on the Watch List, staff does not recommend taking this action, preferring to review the fund's performance during May and June. Staff may come back at the next ARMB meeting with a recommendation to place them on the Watch List.

MR. BADER stated the investment guidelines – domestic and international equities has been approved by the Board, but three lines were left off of the material that came from the printer. Those missing lines have been included in the packet to inform the Board of that language: “in the event the aggregate total of any security held by the ARMB exceeds 5% of the shares outstanding, the ARMB may direct portfolio managers to sell securities to the extent that the aggregate is below 5%.” This indicates the ARMB does not want to have more than 5% of its assets in any one company.

MR. JOHNSON suggested that the ARMB go on record ratifying that this was their intent.

MR. TRIVETTE moved to ratify that the intent of the ARMB was to include the language that had been omitted from the Investment Guidelines for Domestic and International Equities policy. MR. PIHL seconded.

There being no objection, the motion PASSED unanimously.

MR. BADER indicated there is communication from the State's tax consultant, Ice Miller, regarding the plan qualification of the new defined contribution plan. Because the ARMB was warranting that these were tax qualified plans, through the Attorney General's Office Ice Miller was asked if it could be reasonably stated that the ARMB is in a position to make these representations. They replied “Thus, we believe the Plans are entitled to operate and hold themselves out as qualified governmental plans during this period.”

MR. BADER stated that on page 32 of the March 27, 2006 minutes Mr. Brooks offered to assign Department of Administration staff to do a cash flow analysis of the retiree health trust. That process has begun. Charlene Morrison has been assigned to look at cash flows and the intent is to report to the ARMB at its October meeting.

3. Committee Reports

a. Audit Committee

MR. PIHL stated at its February 15, 2006 meeting the Audit Committee approved a charter for the Committee, which is essentially the assignment of responsibilities to the Committee by the ARMB. Approval was delayed until the March meeting, but the matter was not addressed. He explained that the charter is fundamental to the committee proceeding with its work.

CHAIR SCHUBERT asked if the Committee took action on the charter. MR. PIHL stated the Committee approved the charter at its February 15, 2006 meeting.

MR. PIHL moved that the ARMB approve the charter for the Audit Committee. MS. HARBO seconded.

There being no objection, the motion PASSED unanimously.

MR. PIHL stated the Audit Committee met with Kathy Porterfield of KPMG, Susan Taylor and Charlene Morrison with the Department of Administration (DOA), and Gary Bader and Judy Hall with the Department of Revenue (DOR). The Committee was supplied with a great deal of material on audit committees, supplied by KPMG. These materials cover audit committee responsibilities, basic principles for audit committees, oversight of independent auditors, and internal audits. The materials are developed for publicly traded companies, but many principles apply to the ARMB. The materials stress the need for a top down understanding of the need for an audit function. By approving the charter, the Committee has been given a clear outline of its responsibilities. The Attorney General's opinion that will be reviewed tomorrow has some implications for this subject. The Committee reviewed audit timelines for the DOR and DOA Division of Retirement and Benefits. A report was received from Susan Taylor on the development of a middle office function, which is underway. The Audit Committee will meet with State Street to review controls. The next Committee meetings are scheduled for October and November.

b. Investment Advisory Council Selection Committee

MR. SEMMENS stated the Committee met twice in May 2006. The staff solicited applications for the Investment Advisory Council and nine acceptable applications were received. Each appeared to meet the qualifications for the position. The Committee selected four of the nine for interviews; three of those candidates are on the ARMB agenda for interviews tomorrow, June 15, 2006.

4. Fund Financial Presentation

For more information on this presentation, refer to the document entitled "Alaska Retirement Management Board, Financial Report as of April 30, 2006," kept on file at the ARM Board offices.

SUSAN TAYLOR, State Comptroller, stated the balances in the funds are PERS \$9.6 billion and TRS \$4.4 billion, Judicial Retirement Trust Fund \$81 million, and Military Retirement Trust Fund \$16.2 million. The SBS has \$2 billion and Deferred Compensation is almost \$500 million. Because the new defined contribution plan will begin in July, some changes will be made to the

Fund Financial Report. She solicited other suggestions for changes to the Fund Financial Report as the new plan is brought into the report.

MR. PIHL suggested that attention be directed toward the balance of contributions and withdrawals in terms of the concerns of the ARMB. MS. TAYLOR agreed and stated she has been in contact with Charlene Morrison because she believed the fund report is providing comprehensive information about the assets, but there is not the same level of detail for the contributions. Ms. Morrison is aware of the need for this information and she will work with her to provide some similar reporting for the contributions and withdrawals that will give the ARMB more information. She believed Mr. Pihl's remark was directed at the information needed to identify trends. She felt it is realistic to expect more detail at either the October or November ARMB meeting. MR. BADER remarked that he would report on the impacts of the actuary report on strategic planning going forward, the impacts on the ability to take on the requirement for liquidity, and the impact of the contribution rate on the fund.

MR. TRIVETTE asked if November is a reasonable time frame to expect this information. MS. CARPENTER was unsure what the ARMB wants. She noted there is detailed information on employee and employer contributions that can be provided, even by employer, if that level of detail is required.

5. Performance Measurement – 3rd Quarter

For more information on this presentation, refer to the document entitled "Alaska Retirement Management Board, Periods Ended March 31, 2006, Performance Review & Evaluation" kept on file at the ARM Board offices.

MICHAEL O'LEARY with Callan Associates Inc. (CAI) explained he wished to present what has happened in the markets since the first quarter, which was good. The second quarter is the first down market this ARMB has had to endure. MR. BADER stated that the public market fiscal year return as of June 9, 2006 is 10.25% for PERS. MR. O'LEARY stated that this is still an attractive return, but it is lower than it had been. MR. SEMMENS asked what had been the highest return during this fiscal period. MR. O'LEARY indicated that would be through the end of April and the figure would come clear during his presentation.

MR. O'LEARY indicated he has been reformatting his presentations to make them shorter in duration, provide all the needed information, and include information on every portfolio. He stated he would focus on distinct items each quarter. This quarter he would focus on fixed income and the structure of the domestic equity portfolio.

MR. O'LEARY indicated that the high yield managers have done significantly better than the investment grade managers. Similarly, the absolute return managers for the three hedge funds of funds have done better than the investment grade bond market. That portion of the portfolio is likely to undergo a severe test during the current quarter; he suspected negative returns in this area in the June quarter. The absolute return managers have, however, added value relative to the bond market, since inception.

The small cap pool, on balance, has done well. Small cap stocks have been decimated in the current quarter. During the first quarter the Russell 2000 was up nearly 14%, but as of last night

that index was flat on the year. Seeing how the managers have performed during this weak market environment should be telling.

In the large cap equity pool, which is the only major segment of the portfolio that has had disappointing performance, the structural hole is a true value manager. This continues to be the case. The ARMB last year hired Relational who provides some value exposure, but not diversified traditional public market value exposure. Within the large cap pool, Capital Guardian, McKinley and RCM, have done well in the last 12 months by beating the broad market. Tukman continues to suffer in terms of relative performance, but has begun to improve slightly. MR. O'LEARY expected Tukman to do relatively well in the current market environment. COMMISSIONER CORBUS asked why this manager should do well in this market. MR. O'LEARY explained that the large cap companies that have done exceedingly well are large commodity companies and lower quality companies. Those are not the type of companies that Tukman believes in philosophically. The fact that manager has under performed while those types of companies have done well is understandable. In an environment where commodity prices and stocks are falling sharply and there is greater concern about the sustainability of the economic recovery and a greater emphasis on balance sheet quality, combined with the fact their stocks have not done well for 4 or 5 years so they are relatively inexpensive, indicates that they should do well.

MR. O'LEARY stated that for the trailing 12 months the ARMB has performed well both absolutely and relatively with the total funds up 4.7%, better than the policy target of 4.5%. The contributors to performance included significant real estate exposure and that should continue to contribute in the current quarter. Meaningful international exposure, including dedicated emerging markets participation, were positive contributors, but emerging markets will be a negative in the current quarter. International was a wash. Private equity contributed to results through March, but he was unsure whether private equity would help or hurt in the current quarter. The over allocation to small cap was a positive in earlier periods, but will hurt in the current quarter. The absolute return and high yield contributed, but will probably be mixed in the current quarter with the former under performing and the latter a push.

MR. SEMMENS asked if the ARMB portfolio is positioned so that the correlation or lack of correlation will help in the market downturn. MR. O'LEARY stated that in times of true stress most asset categories are highly correlated. Over reasonable periods of 12 months, 24 months, 3 years or 4 years there is a diversification benefit. As seen in the March and December quarters, volatile assets across the board were doing very well. Now they are all doing poorly. DR. MITCHELL concurred with this assessment.

MR. O'LEARY indicated that Deferred Compensation and SBS results are consistent with expectations.

MR. O'LEARY reviewed bond markets and yield curves. Over the first quarter of 2006, beginning of the first quarter 2006, and end of the first quarter 2006 the yield curve is very flat. The yield curve is dependent on the mood of the Federal Reserve and whether they feel more is needed to check the apparent acceleration in inflation. This morning there was news that the CPI for May came in at a slightly higher level than expected, but despite that news, the stock market

is up today. The issue is how high rates will go, how will the restraining of price acceleration slow the economy, and will it make stocks relatively expensive compared to bonds. CAI believes the consensus is that the economy is continuing to grow, albeit slowly, profit growth has been very strong, corporate balance sheets are exceedingly strong, companies have begun to repurchase stock at a substantial pace, and price/earnings ratios do not appear high. A comparison of the earnings yield on broad measures of the market reveals that, given the current level of interest rates, stocks look reasonably priced.

MR. O'LEARY reviewed the returns for the Russell 3000 and the LB Aggregate Bond indices. Through the end of March the Russell 3000 was up over 5% and it is now down- 1% as of yesterday. The Russell 1000 was up 4.5% in the first quarter and the Russell 2000 was up 13.9%; as of last night the Russell 2000 was up .37% and the Russell 1000 was down -1.16%.

MR. SEMMENS asked what these indices measure. MR. O'LEARY explained that the Russell 3000 is a measure of the domestic equity market, represented by the largest 3000 companies in the US, aggregated by size. The Russell 1000 is comprised of the thousand largest companies and the Russell 2000 is comprised of the other two thousand companies in the Russell 3000. The big companies account for much more of the weight of the index than the rest.

MR. O'LEARY stated that during the last quarter growth under performed value; this continues during the decline, but not by much.

MR. O'LEARY next reviewed the asset allocation for PERS as of the end of March. Because equity markets have been strong and bond markets were weak in the March quarter, PERS became over allocated to equities and under allocated to bonds. As Mr. Bader reported, money was shifted from equities to bonds in response to that during the current quarter. Relative to other public funds, the asset allocation of PERS shows no remarkable changes. Compared to other public funds, the PERS pure domestic fixed income weighting is low while real estate and alternative weightings are high. The CAI report contains information on attribution to returns from asset allocation and manager effect, by asset category for the quarter. Over the trailing 12-month period there has been positive contribution from managers and from asset allocation differences, on balance.

MR. SEMMENS asked how asset allocation differences occur. MR. O'LEARY explained they occur in several ways. First, there are constantly cash flows into and out of the portfolios and, as money comes in, it is spread amongst categories and, as money goes out to fund disbursements, it is taken pro rata across the board. The differences in performance by asset category are the bigger driver. He explained that the normal movement of markets creates a need to rebalance. The third reason, and the most difficult for major funds to deal with, is illiquid asset classes like private equity and real estate where the pace at which money can be invested is independent from the shorter-term movements in the market. An under allocation in an asset class by virtue of long drawdown means another asset class is over allocated. MR. SEMMENS noted that the staff has the ability to rebalance within a specified range. MR. O'LEARY confirmed that this is the case.

MR. O'LEARY reviewed the cumulative performance of the PERS and TRS for the last 5 years compared to the target index established by the ARMB policy using passive benchmarks, as well as the CAI public fund database. The performance over the three-year period has been attractive and competitive. Performance over the 5-year period is at median and both PERS and TRS are below the target index. MR. O'LEARY noted that calendar year performance is shown in the CAI report. Long-term performance relative to target is also included.

Across the board, performance for the quarter for SBS and Deferred Compensation was in line with expectations. MR. O'LEARY reviewed the current asset allocation for SBS and new contributions. The old Balanced Fund comprises more than half of the assets. The Long-Term Balanced Fund is now up to 5% of the assets. The 2015 Target Maturity Fund is the largest single target fund. A State Street S&P 500 fund holds 13% of the assets. The Capital Guardian Global fund accounted for 3% of the assets, while 27% of contributions are going toward the Stable Value fund.

MR. BADER asked for an explanation of "tactical asset" for the benefit of the ARMB. MR. O'LEARY stated this is a carry over from the early Deferred Compensation days. Initially Wells Fargo and then EGI had a balanced fund that could theoretically be 100% in or 100% out of equities. It is run quantitatively where EGI is looking at valuations of bonds and stocks and short-term investments and shifting the balances amongst index funds representing those three asset categories to reflect where they think the greatest return potential exists, for the level of risk. The performance of that fund has been good in the short-term, but over the long-term it has not been good.

MR. SEMMENS asked if it is possible or has a comparison been done of the SBS asset allocation to that of PERS. He asked how the SBS allocation compares to a professionally allocated portfolio. MR. O'LEARY replied that CAI does not see participant data. From where the money is invested, the performance of each option can be seen. The options provide a great deal of flexibility. On balance, he thought PERS and TRS produced a competitive return because it can access things like real estate and absolute return and it has lower fees. DR. JENNINGS stated the academic evidence is that there is a 2% performance gap, which is attributable to the factors pointed out by Mr. O'Leary, and from individual investors switching into what was last "hot" at the wrong time. MR. O'LEARY stated much has been written of late about the time-weighted returns of mutual funds and the dollar-weighted returns for those same funds. The former measures the value over time while the latter measures the value of the money invested. The dollar-weighted returns have been less for big funds than time-weighted returns. Part of the popularity of target maturity funds is that they are mixed.

MS. HARBO asked as the PERS and TRS funds are reviewed over time and the DB fund is now closed, would the asset allocation then become more conservative and more liquid over time. MR. O'LEARY thought this is perhaps the biggest issue that the ARMB will need to address. The assumption everyone is making is that the degree of under funding is so substantial that for the foreseeable future one must expect significant net cash inflows. If that assumption is wrong, then the policy is wrong. These systems have an incredibly long life. But as shown in the CIO report, if contributions are not made at a higher rate, assets will deplete. The shorter the time

horizon, the greater the need for conservatism in the policy; a conservative policy should be expected, however, to produce a lower return.

MR. TRIVETTE understood from the attribution analysis the manager effect for both PERS and TRS is negative and asset allocation is positive. MR. O'LEARY stated this is correct for the March quarter. The biggest manager effect is in private equity, but there is no good benchmark for that asset class so a combination of stocks is used as a proxy. For the one-year period, private equity contributed positively. MR. TRIVETTE understood that in the trailing 12 months the manager effect is significant. MR. O'LEARY agreed and noted that during that period there were contributions in domestic equity, domestic fixed income, and international equity.

MR. O'LEARY continued his presentation with a review of the Deferred Compensation plan asset allocation. He noted the Deferred Compensation has a balance of nearly \$500 million. He then reviewed the performance of the SBS options relative to the target. The Balanced Funds, Target Maturity Fund and Index Funds did well. The Long-Term Balanced Fund was slightly behind benchmark. The 2010 Target Maturity fund did better than the benchmark, while the 2015 Target Maturity Fund was at benchmark. The differences between those funds are slight in terms of actual versus target allocation; a higher allocation to domestic equities resulted in under performance because international equities performed better than domestic equities in the period. The BGI Tactical Asset Allocation Fund returned above target for the year and has been close to target, but below target, in the other periods. The Capital Guardian Global Balanced fund has done well. The Citizens Core Growth fund has continued to do well and the T. Rowe Price Small Cap Trust fund has done very well.

MR. O'LEARY reviewed performance of the international exposure including the international component of the Lazard portfolio and the emerging markets exposure. The total international exposure was up 9.71% for the quarter. The EAFE Index was up 9.40% and the MSCI International AC ex US Index was up 9.76%. The international component has done fairly well. Excluding Capital Guardian and JP Morgan emerging markets and looking only at the developed markets, the international returns were better than benchmark. DR. MITCHELL noted that, while the return was better than benchmark, it was below median. MR. O'LEARY stated Brandes has meaningful emerging markets exposure in their developed markets portfolio.

MR. O'LEARY reviewed returns for the absolute return funds. Two of the three hedge funds of funds, Mariner and Crestline, are compared against a sub-group of hedge funds and both have done well relative to their target and peer groups. Cadogan is compared to long-short hedge funds of funds; they are conservative in that group and performed well below the median of that group. He expected that in the June quarter Cadogan will have stronger relative performance because of a more conservative orientation. The returns of these managers are above the bond market returns.

Total domestic fixed income, comprised of BlackRock and the in-house fixed income portfolio, has consistently performed above the investment-grade market benchmarks and during the year was competitive, but only produced a 2.75% return. The in-house component compared to a core bond manager group has done well for some time. BlackRock has been an excellent bond manager and, over the life of their relationship with Alaska, has produced a very attractive return

and generated consistent results. He noted that all returns are pre-fee. On a pre-fee basis over the last year the in-house portfolio returned 2.83% and BlackRock returned 2.53%. MR. PIHL remarked on the cost of each. MR. O'LEARY agreed that the operating fees for the in-house portfolio are significantly lower than the management fees paid to BlackRock. DR. MITCHELL noted that the 10-year results shows that the difference between a 10th and 90th percentile bond manager is 60 to 70 bp, where the difference between a 10th and 90th percentile for international managers is 500 to 600 bp.

MR. O'LEARY reviewed the two new bond managers, ING and McKay Shields, both of which have managed high yield portfolios for less than one year. For the three-quarters of the year, both managers have earned between 4.60% and 4.70%. During that span the LB Aggregate Index has been down. Mondrian, the international bond manager, is managed against a high quality non-dollar bond benchmark; currency volatility has dominated short-term performance, but they have done well.

For the year, the total domestic equity pool produced a return of 14.31% versus the Russell 3000 at 14.28% and the S&P 500 at 11.73%. A major portion of the portfolio is invested in an S&P 500 index fund. Large cap performance for the year was 11.58% versus the S&P 500 at 11.73%; the slight under performance was due to the fact that value-oriented strategies did better than core or growth-oriented strategies and the Fund has an under weighting to the value style. For the March quarter the small cap pool, which reflects the third full quarter of the new small cap managers, did very well.

MR. O'LEARY reviewed the large cap pool characteristics and noted a slight growth bias and an under weight to energy and materials. The large cap pool is compared to the S&P 500 Index in this analysis. He stated the funds are not at an extreme. In terms of the price being paid for securities, it is close to and slightly above median; price to book is close to median, but slightly above; expected earnings growth is close to median, but slightly behind; and current dividend yield is at median, but below the S&P 500. In terms of sector allocation, there is an under weighting in energy.

A review of the small cap pool characteristics shows that pool is close to median with no pronounced overall bias.

MR. O'LEARY concluded with a review of the REIT portfolio, which had excellent returns for the quarter. This return reflects the changes in terms of expanded diversification that was implemented in early January.

MR. TRIVETTE long-term returns of the funds relative to target are net of fees. MR. O'LEARY stated that gross and net returns for each manager are provided in the CAI report, but the figures he presented are gross of fees..

MR. SEMMENS thanked Mr. O'Leary for the information he had provided. He commented that on the way back from the ARMB education conference he read the ARMB policy manual and the vision statement to be the best managed and run fund in the country. There is also a definition of that, which includes a financial performance component and that speaks to

comparison to a risk-adjusted return. He asked what the ARMB should be cognizant of in Mr. O'Leary's presentation to guide it in evaluating whether or not the vision is being reached. MR. O'LEARY suggested financial meters: performance relative to policy target, performance relative to peers, and risk-adjusted graphics, primarily the return relative to standard deviation (Sharpe ratio) shown on page 56 of the report by asset category relative to a market index and relative to peers. He stated he would include a 5-year graph in future reports, noting that choosing the time frame for review is very important. CAI tries to show the current period and other time frames for comparison. MR. SEMMENS noticed that one of the comprehensive graphs indicates that in the last five years the performance has improved; this is important if it is a trend indication, but if it is not, there should be discussion of the changes that are needed. MR. O'LEARY responded that if the Alaska fund is different than the typical fund a comparison to those other funds is not meaningful. For this reason, CAI includes information on asset allocation relative to peer group.

MR. PIHL noted with respect to the returns for the large cap component and the small cap component that when there is a smaller spread between the 10th and 90th percentile it is easy to see the spread between the median and the Alaska fund, but when the spread is larger and the Alaska fund does poorly, it seems the managers are not performing well. MR. O'LEARY noted that there could also be a structural issue. He noted that over the three-year period the median large cap value manager returned 21.43% and the median large cap growth manager returned 15.55%. Over the 5-year period, the median growth manager returned 1.89% and the median value manager returned 7.13%. There was a growth tilt over those periods and that is not attributable to managers. The bias has now been addressed and it is gratifying to see the improvement in performance that has resulted.

BREAK 10:45 a.m. to 11:00 a.m.

6. Small Cap Round Table Discussion

GARY BADER stated the purpose of this format is to hear the views of small cap managers, allow them to exchange ideas with each other and the ARMB, and for the ARMB to become comfortable with those managers.

The manager participants introduced themselves: MIKE SMITH with Lord Abbett; JOHN MULLMAN and RICK MASTAIN with Jennison Associates; NICK GALLUCCIO and JANET BETNER with Trust Company of the West (TCW); STEVEN GOLD with Turner Investment Partners; and STEVE PURVIS and MARK JOHNSON with Luther King Capital Management.

Question: MR. BADER noted that the Federal Reserve has raised interest rates 16 times over two years from 1% to 5%; how has this influenced the investments you are making?

MR. GALLUCIO stated the portfolio weighting in financials is very low relative to the benchmark because with the rising short-term rate environment there is a flat yield curve and banks in particular have to borrow short and lend long, so their net interest margins are being squeezed. As a result, it is hard for them to make money. However, TCW is looking for good regional banks that are over capitalized, that are conservatively managed, and that have an attractive franchise. The takeover activity will abate because large cap banks sell at lower

multiples than small cap banks and they cannot use their paper as currency. As stocks pull back, TCW will accumulate and build that weighting.

MR. GOLD added that in the rising interest rate environment the consumer has less income with which to make purchases, so Turner has been under weighting consumer discretionary. Also with rising energy prices, the middle income and blue collar worker is struggling to handle increased prices at the pump and utilities.

Question: MR. BADER asked what significant risk, if any, is the market neglecting?

MR. MULLMAN stated that overall the market had under priced risk, whether it was emerging markets or risk of an economic slow down; credit risk has been significantly under appreciated in the marketplace. There have been spreads in the high yield marketplace that have come down to unusually low levels.

Question: DR. MITCHELL noted there have been corrections in the last month of 20% to 30% in some cases. He wondered if these corrections were over?

MR. PURVIS agreed that there has been a pull back, but putting the 10% correction into perspective, there has been a multi-year positive performance period for the market and small cap without a correction of this size. Putting the correction against the doubling of small cap stocks since the lows in 2002, this correction is minor. Seasonally, the market is entering a period that is difficult for small cap: the summer doldrums. MR. SMITH agreed with Mr. Purvis. The pull back has been broad based, not differentiating between high and lower quality companies. Valuations are looking more and more compelling. MR. MULLMAN stated the market is most closely focused on what the Federal Reserve will do and if they will stop raising rates. The next Federal Reserve meeting is not until mid-August. He felt it would be difficult for the market to rally in the interim. MR. GALLUCCIO felt the question is whether this is a bear market or a correction in a bull market; he thought it was the latter. The Federal Reserve has successfully engineered a slower economy in the second half of the year. When he talks to companies they indicate that order book is strong, the outlook is strong, visibility is better than it has been in a while, and valuations are cheap. A big rebound will happen.

MR. GOLD added that in talking with company managements and asking “how is business,” they give an economic forecast, but aside from that broad view, their business is very strong.

Question: MR. BADER noted that all these managers were at or above the index as of fiscal year to date. What are the long-term implications to the US market from the growing economies of China and India and will that affect small cap investments?

MR. MULLMAN stated that the emergence of China and India, particularly as consumer economies, has profound implications for the US equity markets and for all global markets, although less in small than in large cap. The initial impact is seen in the rise in commodity prices, which he expected to continue. He expected a bullish run in those commodity prices as those markets continue to develop. There has been discussion of a slowdown and a bubble economy in China; there is political pressure for the Chinese government to stimulate economic

growth. He felt there was likely to be continued strong growth in China through the 2008 Olympics in Beijing and all emerging markets.

Question: MR. BADER asked whether small US companies are going to be able to get into markets in China and India.

MR. GALLUCCIO stated he looks at small companies as the inventory managers of big companies. If global players benefit from demand pull in China and India, the small companies are niche suppliers to those and are secondary participants in that trend.

MR. GOLD stated in terms of the impact on energy and commodity cost, it does not matter where commodities are found, markets will be impacted. There was an article in the *Wall Street Journal* regarding cars in China and per capita they are where the US was in 1915. He noted that the vast majority of Chinese are not in the cities.

MR. SMITH added regarding labor costs that manufacturing and labor intensive manufacturing are moving to China, and IT and service is moving to India as infrastructure has been developed; this is keeping a lid on domestic labor costs.

Question: MR. O'LEARY noted that small cap, as a sector, has done well. Many say that small cap valuations are high relative to large cap valuations. He asked for comment.

MR. GOLD stated JP Morgan has come out with numbers on the universal stocks they follow. They broke the universe into market caps of \$3 billion and less and said the average P/E for these companies was 15 times. Companies \$3 billion and up had an average P/E of 14.7 times. Then they looked at the current consensus for earnings growth rate in the next 12 months and for less than \$3 billion less earnings were expected to grow slightly over 16% and earnings for companies over \$3 billion were expected to grow about 13%.

MR. MULLMAN felt the key was not so much valuation as earnings growth.

Question: MR. O'LEARY asked why should there be more rapid earnings growth in small companies than large?

MR. MULLMAN replied that average profit margins are at lower levels. On a price to sales basis, small caps are cheaper generally because their profit margins have been lowered and they are less mature companies. As they mature and experience better revenue growth, there will be a higher contribution of that to the bottom line. Many small companies can take advantage of secular trends that larger companies cannot.

MR. GALLUCCIO felt that large cap companies are probably cheaper and more attractive than small cap companies because of the quality. He thought they do not go up because hedge funds are playing in the small cap universe. He thought many of the large companies have never been cheaper.

Question: DR. MITCHELL asked for comment on the activity of private equity partnerships in the small cap universe and whether it is worthwhile to be invested in small cap companies today given Sarbanes-Oxley.

MR. GALLUCCIO indicated that it costs small cap companies \$1 to \$2 million annually to comply with Sarbanes-Oxley, which can affect the earnings a \$200 million market cap company. There is \$1 trillion in private equity that is going after companies primarily in small cap. He noted there have been 18 takeovers in TCW's portfolio in the last 9 months. There have been \$1.5 trillion worth of M&A in the world year-to-date, surpassing the year 2000 when there was the Time Warner acquisition that was \$180 billion. These investors are playing in small and mid companies that they can control; but big companies are cheap. MR. MULLMAN agreed with Mr. Galluccio. He stated that one of the most distressing trends his firm has seen in recent months is high quality companies that were good steady growers that did not require outside capital chose to go private rather than staying public, in part because of the burdensome costs of Sarbanes-Oxley, E&O insurance, and owners' fees. He found this distressing because these were good quality companies that his firm would like to keep in its portfolio.

MR. GOLD stated one of the things seen in M&A activity is that large cap companies cannot grow organically enough and have been put in a position where they need to make acquisitions. In order for the large companies to grow, they have to make acquisitions to justify the P/E ratios the market is putting on them.

Question: MR. TRIVETTE asked if small cap stocks could compete realistically in China and India.

MR. SMITH responded that he visited China two years ago out of concern with the small cap companies being displaced by Chinese manufacturers. Many smaller cap companies are recognizing that they need to look at competitive advantages; being the low cost leader is not a sustainable advantage in a global marketplace. Companies are outsourcing overseas and developing manufacturing facilities overseas. He thought small cap companies would be able to compete effectively, given the technologies available. A firm must assess its core competencies because that will have a huge impact on how it is affected by China and India.

Question: MR. O'LEARY noted there has been much interest in small cap both in the US and abroad. He felt it would be useful for the ARMB to hear opinions of how small cap investing outside the US is different than domestic small cap investing in terms of the structure of the markets, liquidity, governance, etc.

MR. GALLUCCIO noted that Japanese companies do not provide much information and they report twice a year rather than four times a year. The information flow and transparency is less internationally than it is in the US.

MR. SMITH stated he had lunch with his firm's international small cap manager three weeks ago who indicated it is an inefficient marketplace, there is not much published research, it is crucial to meet the management teams and get a sense of the drivers. There are more companies that can potentially not list domestically because of Sarbanes-Oxley. There are issues regarding

the legal environment domestically so they are listing in Europe or Asian markets. The international markets have also done extremely well because they are levered to commodities of mineral, paper, and copper, and that has been a big driver recently.

Question: MS. HARBO noted she read about the booming economy in Ireland and decreasing unemployment. She asked if that is a good place for small companies to invest.

MR. SMITH stated the companies to which he has spoken are moving intellectual property to Ireland because of the low tax rate. There is tremendous brain drain, which is the worst thing that can happen to a society, and the lower tax rate has helped.

Question: MR. BADER asked if there are demographic trends developing that offer promise in the area of small cap?

MR. GALLUCCIO replied that the aging of the population would benefit healthcare. His firm bought acute hospital companies and is looking for rehab.

MR. PURVIS stated the demographic trend is not new and he is surprised to see how poorly healthcare stocks have performed in small and large cap in recent years, although it would seem to be a demographic trend in which to invest.

Question: DR. MITCHELL asked how each manager would define the small cap area in which they work by market cap.

MR. GOLD replied that his firm buys companies between \$200 million and \$2 billion. Companies can run above \$2 billion, but they are sold when they reach \$3 billion.

MR. PURVIS stated his firm buys companies between \$200 million and \$2 billion. When they get above \$3 billion they are trimmed back, and when above \$5 billion they are sold. The net result is that the firm's average market cap is similar to the Russell 2000.

MR. GALLUCCIO stated his firm buys companies between \$100 million and \$2 billion with an average weighted market cap of \$1 billion. Some are kept above the upper range as they appreciate, but they are eventually sold.

MR. MULLMAN stated his firm buys companies between \$200 million and \$2 billion and will hold companies up to \$5 billion.

MR. SMITH stated his firm buys companies between \$200 million and \$2.5 billion and let winners run if it makes sense from a risk/reward standpoint.

Question: MR. BADER asked what has surprised you most in the last 12 months?

MR. SMITH responded that he was most surprised by the level of speculation that crept into the market in late 05 and early 06.

MR. MULLMAN replied that he was surprised by the overall strength of small cap earnings, particularly in the industrial and back end of the economy. The firm has routinely had companies that beat earnings estimates for several quarters and put up strong earnings growth and expectations of continued growth going forward.

MR. GALLUCCIO stated he has been surprised by the almost parabolic movement of metals, mining, materials, and energy stocks knowing in retrospect that was fueled primarily by speculation. These stocks are getting crushed because many speculators were borrowing in Chinese yen and using the zero interest rate on the currency to buy commodities. The commodities crashed and they are selling everything to cover their margin calls and small cap stocks are suffering. From this he has learned of the synchronicity of the global market.

MR. GOLD stated he was not surprised as much by the correction in commodities and energy over the last 5 to 6 weeks, but the impact on the rest of the small cap stocks; the fact the market has not attempted to differentiate between good and bad companies and those exposed to the trends just mentioned.

MR. PURVIS stated he was surprised most by the fact that the market has just awoken to the fact there are higher interest rates and higher inflation rates. The Federal Reserve has been raising rates trying to slow the economy. There have been higher energy prices for several years and companies reporting higher raw material costs and suddenly in May 2006 the market realizes there are inflation worries and a slowing economy and made an adjustment.

Question: MR. BADER asked, looking over the next 12 months from a global perspective, into what one asset class would each manager invest?

MR. SMITH stated there is a tremendous pull back in materials and mining stocks and he expected those to benefit from the continued Chinese demand over the next 12 months.

MR. MULLMAN chose US farmland. The US is a low cost producer of agricultural commodities. There will be an ongoing consumption of these commodities around the globe, particularly in China and India where it is increasingly difficult to feed those populations. There is increasing drought and water shortages around the world, decreasing the amount of farmland available to grow crops. Trends like use of ethanol in energy production are also taking acreage away from agricultural commodities.

MR. GALLUCCIO chose large cap growth stocks, noting that they are very cheap, have huge balance sheets, are sitting on a great deal of cash, are pulling back, and are growing slower.

MR. GOLD chose commercial real estate. He noted that transactions in this area continue to be done at cap rates that are high. They are occurring in high barrier markets. People outside the US find US real estate exceptionally attractive.

MR. PURVIS chose small cap, noting that technology has become the great equalizer for those companies. Fifteen years ago large companies had the advantage of getting and putting to work technology; now smaller, more innovative companies can use that technology to their benefit and

they do not have the bureaucracies of the large companies. He stated that when he looks for earnings growth he looks at small, innovative companies with good management that can use technology to their advantage to grow their companies.

Question: MR. O'LEARY stated one of the things every large institutional investor wants is to toy with the notion of portable alpha. There is a general perception that small cap managers, as a group, have a greater potential to beat their benchmarks than do large cap. He asked if that negates the appeal of small cap as a manager captures small cap excess return and puts the money into large cap.

MR. GALLUCCIO stated this is already happening with the hedge funds. When a company misses their earnings slightly the owners will decimate the stocks.

MR. MULLMAN thought one of the ways many hedge funds and large cap investors have participated in the small cap market is through the use of exchange-traded funds (ETF). The use of ETFs in the small cap market creates a distorting effect. The small cap market went up 15% because a hedge fund wanted exposure to small cap stocks. People are now selling those ETFs which leads to small cap under performance. It has created more volatility in the asset class and it has created distorting effects, particularly in the smallest market caps in the Russell index.

MR. SMITH added that volatility is here to stay. Sell side research in small cap is also completely breaking down and this will drive inefficiencies in this space. People who are fundamentally oriented should have a better long-term opportunity in small caps. Investors need to stay disciplined in terms of entry and exit points to take advantage of volatility and inefficiency. MR. O'LEARY asked if Mr. Smith was indicating that brokerage firms are not as committed to providing sell side research. MR. SMITH stated this was the meaning of his statement. Historically, sell side research was good five years ago; today, out of \$250 million market cap names half are not covered. This will continue the strong IPO and secondary markets that are providing fees to banks.

Question: MR. BADER asked whether each fund is open or closed, if a pension fund came to each firm to invest.

MR. SMITH stated that Lord Abbett is closed.

MR. MULLMAN stated that Jennison Associates has several hundred million of remaining capacity in the small cap product.

MR. GALLUCCIO stated Trust Company of the West is closed with the exception of small contributions or contributions from existing clients.

MR. GOLD stated Turner Investment Partners is closed, but several years ago the firm opened a small-mid cap (smid) product that overlaps the small cap product.

MR. PURVIS stated Luther King Capital Management is open, but anticipates closing within the next 12 months.

Question: MR. BADER asked why those firms that are closed made that decision.

MR. GOLD responded that the firm has \$2.5 billion in assets under management in the small cap core strategy and anything more than that makes it difficult to get in and out of stocks in a reasonable time period.

MR. PURVIS stated the firm is focused on managing money for its existing clients and a point is reached where a certain asset size makes executing its strategy difficult.

Question: MR. BADER noted that across the world there are discussions of bird flu and its potential impacts. He asked if these managers' firms are doing anything to prepare for the possible impact of bird flu.

MR. SMITH stated that post 9/11 Lord Abbett developed a broader business continuity plan to deal with a catastrophic event. The firm has off-site work plans and back-up technology sites to support the information needed on a daily basis.

MR. MULLMAN replied that, apart from its business continuity plans, Jennison has done nothing unique for avian flu.

MR. GALLUCCIO indicated his response for Trust Company of the West is the same as Mr. Mullman's for Jennison.

MR. GOLD stated Turner Investment Partners has offices in two locations.

MR. PURVIS stated that all employees of Luther King Capital Management get a flu shot every fall.

Question: MR. BADER asked if high energy costs are here to stay.

MR. GOLD stated that he was not sure the price of oil above \$60 a barrel is here to stay, but a \$10 to \$15 risk premium is built into the price because of the political uncertainty in the Middle East and other places. He argued that oil going back to \$20 to \$30 a barrel is unlikely, however.

MR. PURVIS noted that the price needed to meet the Alaska state budget is \$45 a barrel and he expected it to stay at that for some time.

MR. MULLMAN believed that high energy costs are here to stay.

Question: MR. BADER asked if the risk of corporate malfeasance has been reduced because of Sarbanes-Oxley.

MR. GALLUCCIO stated it was until there was back dating of stock options.

MR. MULLMAN felt that Sarbanes-Oxley clearly helped. In terms of the back dating issues, most of the most egregious examples of that occurred in the 1999 through 2001 time frame when many companies did not have Sarbanes-Oxley procedures in place. The cost of the additional safety achieved with Sarbanes-Oxley was probably not worth the cost that most companies bore.

Question: MR. TRIVETTE asked whether, if the funds were opened and the ARMB had cash to invest, are there sectors into which that would be invested?

MR. GALLUCCIO noted that China accounts for 4% of the world GDP, consumes 9% of the world's energy, 20% of the world's aluminum, 30% of the world's iron ore, and the government of China has made it clear they will reduce energy-content manufacturing by 20% over the next four years. He stated he would not make a big bet on commodities right now and would probably buy technology companies.

LUNCH BREAK 12:00 p.m. to 1:15 p.m.

7. Lord Abbett & Co.

For more information on this presentation, please refer to the document entitled "Lord Abbett Small Cap Core Equity Management, Presentation for Alaska Retirement Management Board" dated June 14, 2006 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, MIKE SMITH and KRISTIN HARPER presented to the Board. MS. HARPER stated the firm is up to over \$106 billion in assets under management. The small cap product is now closed. The firm is focused now on client service, retaining clients and doing the best job possible. Some new products reaching the three-year track record include an international core and an international small cap. She explained the firm will close a product if it is better for the client and then add new products as appropriate.

MR. O'LEARY asked what is the firm's asset distribution between institutional and mutual funds.

MR. SMITH replied that \$1.7 billion is invested in a mutual fund that was closed in January 2006, \$1 billion in three sub-advisor relationships and the rest is separate accounts. MR. O'LEARY asked how much of the \$106 billion is in mutual funds. MS. HARPER replied that mutual funds are 45% of the business. The firm is moving toward separate accounts, institutional accounts, and mutual funds to each be one-third of the business. MR. O'LEARY asked for a description of the structure of the firm. MR. SMITH stated there are 48 partners who own the firm, all of whom are active in the business on a day-to-day basis. By having owners also investors serves the best interests of the clients. MR. O'LEARY asked whether, if the partnership decided to sell out to a large company, the ARMB should be concerned because that would be a cultural change. MR. SMITH responded in the affirmative. He noted that the firm has existed since 1929 and there have been seven managing partner transitions. MS. HARPER stated the name of the firm comes from the two founding partners, Andy Lord and Leon Abbett.

MR. SMITH noted two changes on the investment team. Robert G. Morris is now the CIO; he was formerly the head of equity investments. The firm operates from a de-centralized standpoint,

so this is a non-issue. Craig Leighton joined the firm a year ago to manage healthcare after working at JP Morgan.

MR. SMITH reviewed the firm's philosophy. The firm looks for mispriced stocks with improving fundamentals that can provide capital appreciation. The firm conducts quantitative research to reduce valuation risk and identify signs of positive fundamental change. Two quantitative research steps are followed by fundamental research to reduce business risk and identify a catalyst that will move the stock to fair value. The investment process begins with the Russell 2000 universe that varies among 2,800 stocks throughout the year. The firm looks for companies selling at the lower end of their historic valuation range, those with three-year earnings per share growth of 10% or greater, and those with positive earnings on a prospective basis. The first quantitative screen gives certain valuation characteristics and cuts the universe to 300 stocks. The firm then conducts another quantitative screen for fundamental change. The firm looks at earnings surprises and insider buying, both quantitatively and qualitatively. That screen reduces the field to 150 stocks. The firm then meets with top management, their competitors, and their buyers. Lord Abbett wants to see a catalyst that will drive shareholder value. The firm looks for competitive advantage and wants to be involved with niche players within a larger market.

MR. SMITH stated the portfolio is comprised of 60 to 90 stocks. The fundamentals in the portfolio are strong at the present time and valuations are getting better. Growth prospects look encouraging going forward.

Year-to-date the ARMB portfolio is up 9.1% versus the Russell 2000 Index at 10%. The biggest detractor to performance was homebuilders. The firm believes fundamentals will improve later this year. Speculators became more active in that area than the firm anticipated. The firm benefited from one company in materials and processing and there is market demand for those companies. The portfolio characteristics are generally high quality in terms of growth profile and the firm is buying stocks at a discount from a projected P/E standpoint. The current strategy is to increase exposure to healthcare. Sector allocation is low in the financial services sector, there is no REIT exposure, and there is a low allocation from a technology standpoint. The ten largest holdings comprise one-quarter to one-third of the portfolio. The firm's market outlook is contained in the presentation materials.

DR. MITCHELL asked if the first screen is prospective or historic. MR. SMITH replied that it is historic.

MR. PIHL asked if investment in a company is large or accumulated over time. MR. SMITH replied that this depends on the risk/reward profile of the stock. The firm may scale into a position if it is more cautious about when a catalyst may play out.

8. Turner Investment Partners, Inc.

For more information on this presentation, please refer to the document entitled "Alaska Retirement Management Board Client Review" dated June 14, 2006 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, STEVE GOLD presented to the Board. He stated the firm manages \$21 billion in assets; the core and value team manages \$2.6 billion of that amount. He

stated there have been no changes in terms of personnel in the Hartford-based team. The small cap core strategy is closed.

MR. GOLD stated the process and philosophy of the firm is that it desires out performance in all markets and one particular style does not do that. Stocks are run through both a growth and a value model. The growth model is primarily earnings-based. Within that growth model are different sector models and different factors for each sector. There are 10 to 12 value screens in the value model, primarily a net debt screen that removes the debt from the value and if it is more than 33% of the market cap the stock is potentially attractive, and a cap-ex screen through which the capital spent over the last 5 years compared to the market capitalization. There is then a fundamental analysis. Turner strips out liquid assets when looking at the valuation of a company and then look at the underlying value of the remaining assets. Turner also looks at more than one way to win with a particular stock. Lastly, the firm sets an up side and down side price target with a ratio of two to one.

MR. GOLD reviewed the portfolio construction and risk control process. Turner considers itself to be sector neutral at plus or minus 5% to the Russell 2000. The largest over weight as of April 30, 2006 was in transportation and the largest under weight was in financial services. No more than 5% of the assets in the portfolio are in any single stock. The portfolio is running fully invested with no more than 3% cash. The portfolio has a balance between growth and value stocks that does not go beyond a 60/40 split.

The firm employs a 25/50 sell rule. If a stock goes up 50%, it is automatically reviewed. If a stock goes down 25% it is also automatically reviewed. In general, if a stock is down 25%, it is unlikely to still be in the portfolio.

MR. GOLD reviewed the performance of the portfolio since inception. Performance is up 200 bp through the end of April. The one-year number is up just under 1% and the year-to-date performance is up as well. In terms of performance attribution, over the last twelve months ending April, the firm is up just under 1%. The sectors that contributed the most to the return were financial services and utilities and those that hurt the most were technology and healthcare.

The top ten holdings comprise 15.7% of the portfolio. All of those stocks are still held in the portfolio. The portfolio is positioned with over market weight in financial services and a slight over weighting in REITs.

The average market cap in the portfolio is slightly bigger than the benchmark, growth is higher, and P/E is higher. The portfolio has consistently been at the high end of the holding range and 101 names were in the portfolio at the end of April.

DR. MITCHELL asked if sector neutrality results in buying as stocks rise and is that self-defeating. MR. GOLD replied that the firm is good in terms of picking stocks and less skilled in terms of making top down calls such as sector performance.

MR. SEMMENS asked if this is why the firm does not deviate more than 5% from market weight. MR. GOLD replied in the affirmative.

MR. O'LEARY noted that Tom DiBella, Turner's CIO, had been at Aeltus and then came to Turner. The managers within Turner have been good at gathering assets and delivering good performance. The number of products within Turner has expanded. He asked why the ARMB should not be uncomfortable with that. MR. GOLD responded that the firm has the same group of key people using the same process with the same philosophy and the firm has just added some additional stocks to consider. MR. O'LEARY asked for discussion of the small cap value product. MR. GOLD explained that when Tom McCann left the firm, they thought small cap had \$2.5 billion in capacity and that core would be at \$1.5 value and value at \$1 billion. The small cap core was so successful that it took up much of that \$2.5 billion capacity. He stated Tom DiBella and he started in the business at the same time and both were trained by the same individual.

9. Jennison Associates LLC

For more information on this presentation, please refer to the document entitled "Investment Presentation to Alaska Retirement Management Board by Jennison Associates" dated June 14, 2006 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, JOHN MULLMAN and RICHARD MASTAIN presented to the Board. MR. MASTAIN explained the firm manages a small cap portfolio for Alaska, which is one of several equity capabilities at the firm. All of the equity assets are managed with the same bottom-up fundamental research so there are no competing products. The firm was founded in 1969 and since 1985 has been owned by Prudential Financial. The relationship with Prudential is hands-off. The firm is run as a standalone investment boutique. There have been no changes in personnel except one addition.

MR. MULLMAN stated the firm has \$1.5 billion of assets under management in the small cap style and that product will close at \$2 billion. There is also a smid product that was started two years ago that is just under \$1 billion and will be closed at \$2 billion. He stated the product is managed by a team. Jason Swiatek is the co-manager with him and there is a team of five analysts in addition. Most recently another consumer analyst was added to the team. He felt the team was one of the best in this asset class.

Year-to-date through yesterday the firm was up 2.2% absolute in the ARMB portfolio, 185 basis points ahead of the benchmark. On a fiscal YTD the portfolio is up 9.6%, or 233 basis points ahead of the benchmark. The last month has been disappointing on both an absolute and relative return basis.

MR. MULLMAN noted the firm has out performed on a one-, three- and five-year basis by approximately 400 basis points relative to the benchmark. Over nearly eight years, the small cap core equity portfolio performance has been 50% over the benchmark in all periods and regardless of the market characteristics.

MR. MULLMAN reviewed sector allocation within the portfolio. There is an under weighting in financials and consumer stocks, partly because of the flattening yield curve. The firm is cautious about the slowing economy and the impact on consumers and consumer spending. Some of the best ideas are in the technology and telecommunications area.

Since inception through April 2006 the portfolio return has been 35% or 300 basis points better than the benchmark. There was exposure to gold and aluminum stocks. The firm believes in long-term trends, favoring commodities and industrial stocks. The current correction has been more painful than the firm thought, but these stocks should correct. Energy stocks have contributed positively to performance and those are companies with long-line reserves. Real estate has performed well with CB Richard Ellis Group among the best.

MR. MULLMAN reviewed the current portfolio themes. The firm is not a thematic investor, but rather is a bottom up stock-picker. He highlighted the theme of re-emergency of “old economy” materials and commodities. He commented that newspapers regularly write about the proliferation of new media and video content that will be available in personalized situations. The firm believes in the personalization content delivery. Although those are exciting technologies, the companies will not see significant profits for years to come. One of the things that drives the Internet is electricity and increasingly over the last five years gas-fired plants were built and now the price of gas has doubled and tripled; so perhaps coal-fired plants with scrubbing technologies will be considered. MR. MULLMAN noted that no gasoline refinery has been built in the US in over 40 years. There are many opportunities for attractive investments in older line economies. He stated there is demand from new economies like India and China, but also from older economies. The US has a need to invest in water infrastructure, particularly in the western US. The country needs to think creatively about ways to bring potable water to communities that do not have a potable water source.

MR. WILLIAMS noted that one of the stocks in the portfolio is a barging company on the Mississippi and asked what growth is envisioned there. MR. MULLMAN replied that with the price of gasoline rising, trucks, rail and air freight have become more expensive relative to barges. The number of new barges that have been built in the last 20 years is a fraction of the overall fleet. Many barges have become obsolete. The stock in the portfolio, American Commercial Lines, is vertically integrated and is one of two manufacturers of barges, as well as an operator of barges.

MR. PIHL understood there is an effort to export water out of southeast Alaska to the Los Angeles, California basin.

10. Luther King Capital Management

For more information on this presentation, please refer to the document entitled “Alaska Retirement Management Board, Investment Review” dated June 14, 2006 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, STEVE PURVIS and MARK JOHNSON presented to the Board. MR. PURVIS distributed a summary of updated performance through the end of May, given the sell off in the marketplace. He stated the firm is independent and manages \$7 billion in total, of which \$1.4 billion is in small cap. The goals of the firm are to produce superior returns through rigorous fundamental research, and to lower the downside risk in the marketplace. This is done by investing in high quality, competitively advantaged companies that can re-invest their profits into their core business in order to grow the value of the business over time. There are many resources at the disposal of small cap managers in the firm to generate good stock ideas.

Fifteen members on the investment staff provide ideas, sector analysts follow sectors and understand the dynamics of the sector or industry, and supplemented by small cap specialists that look at specific ideas.

MR. PURVIS reviewed the history of the firm, which has operated a small cap strategy since 1994. The goal of the firm is to produce superior returns with lower volatility and the firm has achieved those goals through a rigorous fundamental research approach. The positive alpha generated by the firm comes from superior stock selection and sector allocation decisions. The portfolio has lower beta because it invests in existing companies that are already making money. By taking out the more speculative portion of the Russell 2000, the firm's beta will be lower than the benchmark. The firm tends to capture 87% of the up market, measured quarterly, and 70% of the down side. Over time, the firm has been able to add value over the benchmark. He and Luther King have been co-managers of the strategy since 1998. Over the last 11 years there have been many types of markets, during which the firm's strategy has prevailed. While the firm has not out performed in every single period over the 11 years, over time the compound return is positive.

MR. PURVIS explained that because Luther King is an independent firm, the resources of the firm are reinvested to the benefit of the clients. Four new analysts have been added in recent months.

MR. PURVIS reported that the ARMB portfolio had a strong first quarter. The firm has held its own in the down market of late and is still up on a year to date basis versus the benchmark.

CHAIR SCHUBERT asked if a particular sector bet has paid off, noting the firm's returns are outstanding. MR. PURVIS replied that doing an attribution analysis of 2005, 95% of the portfolio's performance was driven by individual stock selection and 5% by sector allocation decisions. The portfolio was over weight in energy, which was a big beneficiary in 2005. The portfolio had strong stocks in all sectors. The firm tends to have a low turnover of 40% to 50% annually. The companies that contributed positively in 2005 were bought in 2002 or 2003 or even before that. He indicated this portfolio has benefited from merger and acquisition activity; 8 out of 90 portfolio companies were acquired last year and 7 have been acquired this year.

MR. PURVIS stated the firm is well diversified and does not typically go more than 500 basis points over the benchmark. The firm might be under weight significantly in an area if no good investment ideas are identified. There are typically 85 to 90 stocks in the portfolio. The firm tries to not take undue stock specific risk, so when individual positions reach 2%, they are trimmed.

MR. PURVIS reviewed the top 15 holdings in the portfolio as of March 31, 2006. He highlighted the small cap market weights. As a high quality investor, the firm invests in companies with a return on equity that is greater than the benchmark, that have debt that is below the benchmark, and that can re-invest back into the business and grow the business over time so they have a higher forward growth rate than the benchmark. The P/E of the companies in the portfolio tends to be lower than that of the benchmark.

MR. PURVIS noted the handout he had distributed to the ARMB shows that the firm is still ahead of the benchmark, while it is slipping slightly in June, a month during which the market has experienced an across the board sell down. Not surprisingly, in a market sell off, people want to first sell lower quality stocks; this means Luther King out performs in the first part of the move down in the market. When all those stocks are sold, the higher quality stocks are left and Luther King experiences some downdraft from that.

MR. O'LEARY asked that the organization be described, given that this group of trustees did not hire the firm. MR. JOHNSON stated the firm is independent, which serves its clients well. The firm's revenues are put where they most benefit the clients. He stated that Mr. King wants the firm to survive him. There are eight shareholders in the firm, including Mr. Purvis. Other members of the investment staff are anticipated to become shareholders of the firm in the coming years. Mr. King sells a like amount of stock offered to the shareholders back to the company. The succession plan is like that of Dodge & Cox where large shareholders are providing stock for new shareholders. The King family will own the majority of the stock going forward. A work ethic and culture has been established by Mr. King that will continue going forward. MR. O'LEARY understood the firm's independence is culturally significant so the ARMB should be concerned if the firm is acquired. MR. JOHNSON agreed that this is the case. He noted that the firm started in 1979 and there have been many opportunities to sell. Mr. King would rather have the firm than the money. It is the clients' firm and that is how it is viewed. When a firm is sold, the culture can change and the psychology can change, and that would be a negative for this firm. MR. PURVIS added that all the members of the investment staff invest in the small cap strategy through a mutual fund.

11. TCW Asset Management

For more information on this presentation, please refer to the document entitled "TCW Value Added, Client Review: Alaska Retirement Management Board" dated June 14, 2006 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, NICK GALLUCCIO and JANA BUETTNER presented to the Board. MS. BUETTNER stated she has been with the firm for 9 years and for the last 5 years she has been with Steve McDonald covering the firm's West Coast and Middle East clients. TCW was established in 1971 and has \$132 billion in assets under management with more than 1,400 institutional and private investors and 31,000 retail investors. In 2001, the firm became a subsidiary of Societe Generale. The relationship with that parent company is hands-off.

MS. BUETTNER reviewed assets under management, which is comprised of nearly 50% US equities and nearly 50% US fixed income. There is a small percentage in alternative investments and international. US fixed income investment is predominantly mortgage-backed securities (MBX). The US equity products of the firm include \$2 billion in the Value Added product.

The Value Added strategy began in 1984 and it has a strong management team and analyst team, as well as a dedicated trader. Some of the firm's clients have been with the firm since the inception of this product in 1984.

MR. GALLUCCIO stated that on an absolute basis the ARMB investment began with \$229 million, there have been net withdrawals of \$15 million, and today the account has assets of

\$319 million. The first March 2006 quarter performance was good, preceded by a strong fourth quarter of 2005. The ARMB money came into this strategy after the fund had a strong run and there has been a 15-month streak where the positioning of the portfolio did not act well. The firm tries to stay focused and find inefficiently priced stocks that will make money for the clients. In fourth quarter 2005 there was a good out performance and in first quarter 2006 and YTD the firm is out performing the benchmark. The one-year number is good, the two- year is bad, and the three-year number is good. As good earnings continue, the since inception numbers will improve. He noted that the firm's style of investing requires patience.

MR. GALLUCCIO reviewed cumulative returns of the portfolio over time; the compounding effect is positive over time. The portfolio has out performed the Russell 2000 in 70 out of 77 rolling quarter three-year periods and 69 out of 69 rolling quarter 5-year periods since 1987 and 1989, respectively.

MR. GALLUCCIO explained that the metrics used to buy companies in the ARMB portfolio are low price to book, low P/E, low price-to-book, a strong balance sheet, excess cash flow, potential earnings turnaround, stock selling at a discount to the company's break up value, and low market cap to sales. The firm buys stocks and waits and is then rewarded by companies being acquired. He expected the rate of acquisition would increase given the \$1 trillion in cash sitting in banks awaiting opportunities to acquire.

The portfolio sells at 2.2 times book value and 11 times normalized earnings. Most of the companies have cash and no debt. The firm looks for niche companies whose competitive position will not be eroded by foreign competition. The firm meets with all companies in which it invests and has a collegial investment process and a strong investment discipline. The firm looks at the world on an absolute return basis rather than the benchmark.

The firm's buy discipline involves unrecognized asset value, turnarounds, undervalued growth, and emerging growth. Companies are sold when they reach a price target based on normalized earnings.

Today the portfolio sells at 1.9 times book value compared to the index at 2.6 times book value; 1.2 times revenues; and has a low current yield. The portfolio owns about 200 stocks with an average market cap of \$1.1 billion.

The portfolio has 27.9% in unrecognized asset values, 29.5% in turnarounds, 27.9% in undervalued growth, and 14.7% in emerging growth. The flat yield curve will not allow financial intermediaries to make the profits they have historically enjoyed. The portfolio is over weighted in technology and producer durables.

MR. GALLUCCIO reviewed the quarterly letter to clients from the firm, which states that "in recent months there has been a surge of acquisition activity among small and medium companies, including a number of our holdings, which were acquired by competitors or private equity firms. Among the companies in your portfolio that have been recently merged, acquired or are currently being shopped for sale are Thomas Nelson, Inc., J Jill, SBS Technologies, Excel Technology, Ade Corporation, Helix Energy Solutions Group, Stewart and Stevenson, Prime

Hospitality, Brookstone, and Thomas Industries...” He stated that this has not happened for quite a while. Since the close of the quarter three other companies have been bought and yesterday Zale Corporation was approached and turned down an offer from a British retailer at a nice premium.

DR. MITCHELL noted that a number of other managers who characterize themselves as bottom-up stock pickers, as does TCW, would argue that sector neutrality would complement that style. MR. GALLUCCIO agreed that this is true, but sectors sometimes become over weight because that is the only place a stock can be found.

MR. O’LEARY noted that Mr. Galluccio is an experienced investor and it would seem to him that one of the things Dr. Mitchell pointed out is a striking difference from the other managers is this firm’s greater willingness to be un-benchmark-like. Another difference is the focus on normalized earnings. He asked how that focus on normalized earnings factors into the firm’s decision whether or not a stock is attractive. MR. GALLUCCIO replied the firm typically buys stocks that are going through the downturn of the cycle. Companies are bought when earnings are depressed, so multiples look high over 12 months. As a company’s earnings get better a normalized number is put to that. The firm looks at price-to-book, historical earnings, cash flow generation, and the fact that many companies have a market cap 2 times to 3 times the net of the balance sheet. MR. O’LEARY added that nearly every bottom up manager must have somewhat of a top down mindset when making earnings forecasts for companies that are sensitive to the earnings of others. Looking back on the unfortunate timing of this firm’s hiring, he believed there was a cyclical recovery bet that justified early decisions that took longer than expected to play out. MR. GALLUCCIO agreed with this assessment. The ARMB portfolio was funded in February 2002, followed by the worst stock market since 1929. The portfolio initially lost money, then made up all of the money that had been lost, and now is making up the performance gap of the index. The portfolio was positioned for a good recovery in business and it took longer for the capital spending cycle to come through for the holdings, but now that it has, there are takeovers.

BREAK 2:50 p.m. to 3:00 p.m.

12. McKinley Capital Management

For more information on this presentation, please refer to the document entitled “Account Review Presentation for the Alaska Retirement Management Board” dated June 14, 2006 and kept on file at the ARM Board offices.

After introduction by Mr. Bader, ROB GILLAM and ALEX SLIVKA presented to the Board. This presentation is on the international mandate awarded to this firm slightly over one year ago. MR. BADER noted that this mandate has been performing extremely well. MR. SLIVKA introduced Mr. Gillam, Director of Global Equities, who has oversight and investment responsibility for all of McKinley’s portfolios, including non-US, global, and domestic products. The firm’s investment process remains in place; the same team employs the same investment process for the ARMB’s non-US and large cap portfolio. The firm is independently owned with an incentive stock option plan. No ownership changes are expected, with the exception of ongoing ISO plan participation, which is reviewed annually. In 2005, two employees were added to the ISO plan. As the firm’s assets have grown, the team has been built to ensure the firm can

meet the needs of its clients. The firm's client base remains diverse, including corporate and public plans, both large and small, Taft-Hartley plans, foundations, endowments, and sub-advisor relationships. In the last year assets under management have grown from \$6.5 billion to \$10 billion, gaining \$2 billion in new institutional, primarily in non-US growth strategies. The firm has set guidelines for each portfolio regarding the maximum amount of assets that can be managed without affecting the firm's ability to add alpha. The US small cap strategy remains closed to new clients and \$10 to \$12 billion has been set as the level at which the non-US growth product would close to new clients.

Performance for the non-US and global strategies continues to be strong over all time periods. The focus on equal active weight in the large cap space since the beginning of 2005 has had a positive impact as well. MR. SLIVKA noted that returns for a developed-only composite are now being shown. This product, like all of McKinley's products, was created at the request of a client. There is now over \$1 billion in developed-only mandates.

MR. O'LEARY asked for information on the two products McKinley manages for the ARMB. MR. SLIVKA explained that the ARMB is invested in the Non-US Growth product that had a first quarter return of 12.17%, as well as in the Large Cap 1000.

MR. GILLAM stated the firm's philosophy and stated the firm continues to believe that excess returns are possible. All portfolios in all mandates are structured the same. There is a qualitative review involved in the process, underpinned with quantitative screens. The firm is a bottom-up, growth focused manager. There are some general characteristics in all of the firm's products, which include stock picking, momentum, and growth.

The quantitative process is a nomination process that first takes a large group of stocks and narrows them down to a subset. The analysis involves factors including risk adjusted relative returns, earnings growth acceleration, and liquidity. Those screens are applied to the universe and a nomination set of securities is created that McKinley's portfolio managers whittle down into the actual portfolio. The portfolio managers use a qualitative overlay to do so. This process determines which of the quantitatively attractive securities has reasonable and sustainable earnings. All seven portfolio managers at the firm are responsible for all of the products. The firm is looking to find companies with earnings that are rising faster than market expectations. McKinley finds the best analyst on each company it considers, ranks them from top to bottom, and then focuses on those companies about which they are optimistic.

MR. SEMMENS asked who employs the analysts. MR. GILLAM replied those analysts are employed by firms such as Merrill Lynch, Goldman Sachs, and boutique firms across the world. The firm does not have its own analysts because of single opinion bias. McKinley wants to understand who the most accurate analyst is and why their opinion is different from others. MR. SEMMENS asked if a trailing metric is used to determine who the smartest analyst is. MR. GILLAM replied that analysts are quantitatively ranked from best to worst and then the focus is on the best analysts who simultaneously are the most optimistic in terms of earnings expectations.

MR. GILLAM stated the portfolio is balanced and has no sector, country, industry, or size bets. McKinley wants to buy the best stocks in each category. The firm has an ironclad sell discipline; if something does not work out, it is sold.

MR. GILLAM stated the performance for the Non-US portfolio has been good in the last year. The market has been good, particularly for this firm's style. May was a difficult month and McKinley tracked the benchmark in that month. The firm out performed growth benchmarks, although not the EAFE Index, for the month of May.

MR. GILLAM noted that the ARMB portfolio is fully invested with very little cash. The portfolio characteristics include a significantly greater earnings growth than the EAFE Index. The valuation paid for that greater earnings growth is less than the market.

MR. GILLAM noted that the top ten holdings in the portfolio are shown in the presentation materials in absolute percentages, not relative percentages. The ARMB portfolio is broadly diversified in terms of sectors. The presentation includes data on country weights for countries that are in the benchmark, as well as those that are bought opportunistically but that are not in the benchmark. This balance between countries and sectors resulted in the better performance of the portfolio during the difficult market in May.

DR. JENNINGS asked how much emerging markets exposure should be expected in this portfolio. MR. GILLAM indicated that emerging markets exposure has averaged 12% to 13%. It has gone to 0% and it should not go over 20%. The firm does not have a greater investment in emerging markets because many of the companies that were performing well did not have the earnings growth to sustain it.

MR. GILLAM stated the portfolio equal active weight was tightened at the beginning of 2005 and that has helped performance as well.

DR. JENNINGS asked how the combination of the ARMB's mandates with McKinley compares to the global product. MR. GILLAM responded that the three products are completely separate with different benchmarks and universes; there is, however, cross over. The mandate of a global mandate is value added and that is achieved through flexibility. That flexibility is not possible with two stand-alone mandates. McKinley analyzes the combination of the US large cap and non-US at the index weight in comparison to the global product and has found that the global product has a better risk/return trade-off.

COMMISSIONER CORBUS asked what percentage of the firm is owned by the employees that participate in stock options. MR. GILLAM indicated that because it is a stock option program, none of the firm is owned by the employees, so his father continues to own 100% of the underlying equity. However, 27% of the equity has a call written against it that employees can exercise at will.

MR. PIHL asked for discussion of the firm's sell strategy. MR. GILLAM stated that the firm has a strong sell discipline and it is in many ways the mirror image of the buy discipline. If the stock does not meet the benchmark, it is sold. If the company is no longer earning at the same rate, it is

sold. If a company fails to meet earnings expectations, it is sold. There is a valuation parameter in terms of not owning companies that have gone up more than their growth profile. Stocks are sold if the portfolio gets out of balance. Country factors that are considered include nationalization, war, or capital controls that would cause a country to take away assets. Fraud is also considered. There is no qualitative judgment or opinion in the sell process.

MR. O'LEARY asked for an update on the number of investment professionals at the firm. MR. GILLAM stated there are now seven quantitative analysts, one of which was added last year. There continue to be seven portfolio managers. Some administrative staff has also been added. MR. O'LEARY recalled that employees are awarded an option and the value of that award is predicated on a formula that is a function of the firm's revenue and assets under management. That same formula is used through subsequent years to create a value for that option. Theoretically, when the opportunity comes to exercise the option, one could go to a bank and borrow money to buy the stock. He asked if employees have to buy the stock. MR. GILLAM replied that these are 10-year live options that are issued every year. The value of those options is predicated on the average of three valuation parameters: net income, assets under management, and revenue. Employees could borrow money and exercise the options and sell them; there is a provision to sell them back to McKinley. The firm has the discretion and authority with respect to them selling the option. MR. O'LEARY asked if the price of an option is determined on the date of award so that each year the price could be different. MR. GILLAM confirmed that the price of an option is based on each year.

MR. SEMMENS stated he heard negative comments on US financials today and he was surprised to hear McKinley's positive view. He asked if the increase in interest rates in the US would affect their view of financials in other countries. MR. GILLAM stated the firm is under weight financials but there is a 23% weighting nonetheless. The only thing important to McKinley in owning financials is if they have a good earnings growth profile. Foreign financials have historically been poorly run. As they have become more globalized, their cost structure has radically improved. There is so much more earnings growth from that improvement that, even if interest rates go the wrong way, it is not that relevant to their bottom line. There are also those who focus on real estate, which is booming in Europe.

CHAIR SCHUBERT noted that McKinley has managed for the ASPIB and ARMB for just over 8 years and had just under \$1 billion under management and was given \$50 million by ASPIB. The firm now has \$10 billion under management and has \$700 million of the ARMB money.

MR. BADER thanked McKinley for making their research staff available to the DOR staff, expressing appreciation for their willingness to help other Alaskans become better investors.

CHAIR SCHUBERT stated on a personal note that the ARMB is proud of McKinley as an Alaskan firm.

13. Recommendation - RCM Global Technology Fund

GARY BADER stated that at its March meeting the ARMB had a presentation from RCM on the Global Technology Fund. This firm's history with this fund has been impressive. After their presentation, ARMB suggested that there be a review and discussion of the possible inclusion of

this in the ARMB mandates. This product has had strong 10-year performance. It focuses on identifying major trends in technology. It has a strong overlap with the growth fund in which the ARMB is presently invested.

Callan Associates Inc. (CAI) has done a thorough analysis of this fund and those materials have been provided to the ARMB. ARMB already has a bias toward growth, particularly in large cap. If this fund were added to the ARMB mandates, it would have an overlap with many securities the ARMB already owns. For this reason, after discussion with staff, the IAC and CAI, the staff is recommending that the ARMB not invest in this mandate. It was the view of the IAC, Mr. O'Leary and staff that this is not a bad investment, but it is not a good fit with the ARMB's other investments.

CHAIR SCHUBERT noted that the performance numbers of this mandate are impressive, so it would seem hard to turn down. While she understood the rationale to not invest based on the duplication and over weight in growth, given the return numbers it is hard to not make this investment.

MR. SEMMENS was impressed with Walter Price, the co-founder of this product, and found him very compelling. However, he understood that the ARMB is already invested in these stocks and asked if investing in this fund would be tantamount to a change in policy. MR. BADER clarified that this is not his position; the product is worthy of the ARMB review, however, there are times when the existing portfolio has one-third of what is in this fund and the investment management fees on this fund are 75 basis points, whereas the current incremental fee is 30 basis points. Those are the considerations.

MR. WILLIAMS also appreciated the fact that Mr. Price has been with RCM for 32 years and there is a high degree of key man exposure.

MR. O'LEARY stated that Walter Price and Huachen Chen, co-managers of the product, are a complementary team. For people who have been as successful as they, they tend to enjoy what they are doing. Mr. Price leaving would be reason enough to terminate the relationship. The portfolio team has been responsible for the results generated, primarily these two individuals. He noted that much of the record was based on a small asset base and the manner in which they were attempting to manage the portfolio changed. When they began, they wanted to never lose money, but during the dotcom period they realized they could not accomplish both objectives and they tilted toward relative performance. The SEC's definitions of what can now be called a global technology fund have changed, so the mutual fund is not called that. This project, when managed on a separate account basis, is still called global technology.

MR. O'LEARY noted there was not a good benchmark or peer group against which to measure this product. Because of this CAI reviewed both aggressive growth managers, which are primarily investing in US only securities, and the LIPOR Science & Technology Mutual Funds, as well as the Goldman Sachs Technology Index. The performance of the RCM Global Technology Fund has been good relatively.

MR. O'LEARY stated that the conclusion from the review was that this is a very aggressive product, it is well managed, and there is key investment professional exposure. The biggest challenge is where it would fit in the ARMB portfolio, which currently has a growth bias. Many of the names in this portfolio are already held in the current ARMB portfolio.

DR. JENNINGS noted that currently the ARMB does not have a sector fund approach. He encouraged that if this is appealing, the ARMB investigate a multi-sector approach and then determine where a fund like this would fit into that strategy. He noted that there is a great deal of risk associated with a single sector. There may be investments available that could be combined to achieve diversification and good returns.

MR. O'BRIEN added that he does not like the sector fund approach. The fees associated with that approach are an issue, as is overlap with existing ARMB portfolios. He did not recommend that the ARMB invest in this portfolio, but noted that if an investment was made at the \$40 million level it would not be a large investment.

DR. MITCHELL feels the ARMB portfolio needs more diversification, not less, and he thought there is already enough, if not too much, investment in US growth securities.

MR. PIHL moved to agree with staff recommendation that the ARMB elect not to invest in the RCM Global Technology Fund. MS. HARBO seconded. CHAIR SCHUBERT asked if this item requires action. MR. BADER replied in the negative. MR. PIHL *withdrew his motion.*

14. SPARX-Japan Corporate Governance – Update Report/Recommendation

GARY BADER stated the ARMB favorably received a presentation from this firm, a corporate governance firm that operates in Japan. He thought ARMB trustees were struck by the high fee of 2% and 20% of anything they earn over the index. This is extremely expensive for the type of fund in which the ARMB would participate. MR. O'LEARY noted this firm has been aggressive in combining with other companies and bought one recently. MR. BADER indicated that this event would have placed them on the Watch List. Staff feels this mandate was worth considering, but did not recommend investment.

CHAIR SCHUBERT clarified that this item does not require action.

15. Recommendation: Cost Saving Proposal

a. BlackRock Financial Management

MR. BADER stated this presentation is based on the premise that: 1) the ARMB cannot distribute gross returns, but can only provide to the retirement systems what is left over after paying fees; and 2) that it is possible to have above average investment results and achieve that with Alaskans. For the past three years the in-house fixed income portfolio has been run by a very skilled team of investment professionals. He recommended terminating a manager that has a very good record of investment, based on the existence of a better alternative in the internal fixed income team.

MR. BADER stated that when he was on the ASPIB he believed it was necessary to have a firm with the same mandate as the internal staff in order for there to be a benchmark against which the staff compared itself daily and which it tried to out perform. The initial placement with BlackRock was \$125 million, which is a significant figure, but not one that would tilt the returns of the fund. Over the years, there have been changes in the internal staff, and one period in particular where the rate of staff change was significant. In retrospect, some things could have been done differently. In particular two investments were of interest to the ASPIB and a decision was made to take \$1 billion from internal staff and place that under the investment with BlackRock. This firm has been a very good investment manager.

MR. BADER referred to pages 28-29 of the CAI March 2006 performance report that outline the investment returns of the in-house fixed income team and BlackRock. The three-year returns for BlackRock and the internal team reflect the period during which he has been CIO and Mr. Mitchell has been fixed income portfolio manager. During that period, the internal team has had better returns than BlackRock. BlackRock's three-year gross returns were 3.34% while the internal team's returns were 3.45%. He attributed the good returns achieved by the internal team to the able team members and their hard work. The out performance of the internal fixed income team over BlackRock for that three-year period would amount to \$3,387,000. The investment management fees paid to BlackRock over those three years was \$4,338,000. The fund would have been better off by \$7.7 million over this three-year period had the funds been invested internally. The 5-year net of fees return for BlackRock was 5.31% versus that of the internal team of 5.25%; however, that was a time of extreme turnover in the staff. It is reasonable for the ARMB to ask, and the IAC asked this question, how vulnerable is the portfolio from a loss of investment staff. He submitted that the staff is not the same as the staff was four years ago. There have been additions to the staff, including Mr. Colton who is a CFA and Mr. Sikes who has worked alongside Mr. Mitchell for five years. Furthermore, contact has been made with State Street Bank and they are agreeable to running the fixed income portfolio for the ARMB if there is need to do so. This was done when Bob Storer left his position as CIO. He believed it is best for the fund to make this change and recommended it to the ARMB.

MR. WILLIAMS asked for discussion of the added risk versus expected return, i.e. the potential staffing situations versus the savings of fees. MR. BADER responded that if the \$7.7 million were made available to staff, there would be little worry of turnover. CHAIR SCHUBERT stated that there are constraints in terms of state personnel rules, which was of concern to the ASPIB. Years ago attempts were made to get legislation to authorize independent authority because the pension systems seem to serve as training ground for the APFC and others. MR. WILLIAMS agreed that Mr. Mitchell has done an excellent job, but as a trustee he felt he must recognize risk versus reward issues. MR. BADER stated that it is a simple process to ask State Street to take responsibility for this fund. Weighing the \$7.7 million savings versus the cost of a few days where funds are not invested, he feels it is worthwhile.

MR. SEMMENS moved to accept the recommendation of staff to discontinue BlackRock's management. MR. TRIVETTE seconded.

COMMISSIONER CORBUS asked if a standby arrangement with State Street would be formalized. MR. BADER replied in the affirmative. He stated there have already been

discussions with State Street. He has not conferred with his team whether there should be one contract with State Street or a contract with State Street for fixed income and with RCM for equities.

CHAIR SCHUBERT recalled that when all of the money was internally managed and external management was explored. That decision was made not because internal managers were not performing well, but as an insurance policy so that if something happened to key staff someone could step in and more actively manage the funds rather than contracting with State Street, which would essentially serve as a placeholder. Since Mr. Bader became CIO, there has been the greatest degree of stability since Mr. Storer was CIO. Before Mr. Bader joined the staff it seemed chaotic and there was a huge turnover. She has seen staff picked off repeatedly. In some respects this is a compliment in terms of hiring and training, but she could not support the motion because she thought the reasons BlackRock was hired are still in place.

MR. O'LEARY stated BlackRock is one of the finest fixed income money managers and they have done a terrific job for the pension systems. He noted that at the time they were hired he was asked whether the in-house program should be externally managed and he answered to both the pension system and to the APFC that he saw no reason why, on an after-fee basis, a large pool of money professionally managed cannot do as well. The key factor in his opinion is that it is after-fee. Among the benefits of having BlackRock, particularly when they were hired, was that the benchmark had changed from the LB Government/Corporate Index to the LB Aggregate Index and the internal staff had no experience directly dealing with mortgage-related securities. BlackRock was also viewed as a source of education and an additional resource to the staff. He noted there is a narrow spread between top and bottom quartile performers in asset classes such as bonds and the savings on fees can have a big effect.

MR. O'LEARY further noted that domestic fixed income, as a proportion of the total fund, has declined markedly. The ARMB has expanded into areas such as high yield bonds and managing high yield bonds in-house would be a risky proposition. He noted that retaining BlackRock in a reduced capacity would not have much effect in the investment grade fixed income area.

MR. PIHL asked if the level of communications and availability of information that are available now, compared with the time when an external manager was hired, make professional in-house management of a portfolio easier. MR. O'LEARY state that the size, experience, and tenure of the current staff is greater than it has been in the past.

MR. SEMMENS supported the motion, noting that the key person dilemma exists in either the in-house or the external management situation. The issue then becomes money and \$7.7 million is a lot of money. He noted that this is not the first time staff has come forward with an idea to either save money or make money. He is also generally supportive of bringing things in-house.

MR. TRIVETTE stated that the system does not have as much cash as in the past and the fees seem to rise as there are less funds with BlackRock, so he has concern that their fees will continue to increase as the percentage of funds with them declines.

CHAIR SCHUBERT noted that her concern is not related to the staff themselves or any performance issues. During the time there was a large staff transition, the systems were fortunate that Commissioner Corbus had the foresight to ask Gary Bader to join the staff as CIO.

By roll call vote, the motion PASSED with Ms. Schubert dissenting.

b. Townsend Consultants – Discussion and table

MR. BADER stated that when this item was put on the agenda staff reviewed the \$175,000 per year retainer being paid to Townsend Consultants as greater than it should be given that their consulting contract also has an hourly rate for special projects. Staff spoke with Ms. Balsamo at Townsend recently to let her know what was being proposed and discovered that her office had been trying to contact Mr. Bader to set up a meeting to visit him. She told Mr. Bader that she is going to be leaving Townsend. Last week he attended a meeting with Ms. Yolanis, a principal at Townsend and the alternate on the ARMB account, and one of her associates. There were discussions of how service could be improved, but he reiterated to them that the recommendation from staff to the ARMB is not based on Ms. Balsamo's competency or anything of that nature, rather it is about money. He agreed with Ms. Yolanis that there was probably some misunderstanding about the amount of support being provided to staff and how that was being billed. He indicated to her that he would ask the ARMB to not take action until there is an opportunity to meet and perhaps reach resolution to address the concerns with their fee structure.

MS. HARBO moved to table a discussion of Townsend Consultants until the October 2006 ARMB meeting. MR. TRIVETTE seconded.

MR. TRIVETTE assumed there was a possibility to come to resolution, given the staff's recommendation to table this matter. MR. BADER stated that he clarified to them that the ARMB is not looking for services for which it does not pay and conversely does not wish to pay for services it does not receive.

There being no objection, the motion PASSED unanimously.

RECESS 4:30 p.m.

**ALASKA RETIREMENT MANAGEMENT BOARD
MEETING**

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

MINUTES OF
June 14-15, 2006

Thursday, June 15, 2006

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
Scott Nordstrand
Mike Williams

ARM Board Members Absent

Bill Corbus

Consultants Present

Rob Johnson, Legal Counsel
Michael O'Leary, CAI

IAC Members Present

Tim O'Brien
William Jennings
Jerrold Mitchell

Revenue Staff

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

Judy Hall, ARMB Liaison Officer

Department of Administration Staff

Melanie Millhorn, Deputy Commissioner, Department of Administration
Traci Carpenter, Director, Division of Retirement and Benefits, Department
of Administration

Department of Law

Mike Barnhill, Assistant Attorney General

16. Interest Rate Established for PERS/TRS

Mandatory Contribution Accounts

MR. BADER stated in 2005 when the Legislature passed SB141 creating the Alaska Retirement Management Board (ARMB), it specified certain powers and duties of the board, among which was a requirement for the board to determine a rate of interest to be credited annually to each member's contribution account for PERS (AS 39.35.100) and TRS (AS 14.25.145). Those statutes refer to the existing defined benefit contribution plan and state that the board is to adopt the rate of interest based on the probable success of achieving that rate on a long-term basis. The board is also allowed to change the rate of interest occasionally at their discretion. In the recent legislative audit there was some comment that this had not been investigated for several years.

Staff in the Department of Revenue (DOR) reviewed several interest-earning devices in preparing the recommendation to the board to set the rate. Staff considered whether, since the rate has been set at 4.50% and has not been changed for several years, there is an issue of diminishment of benefits based on the statutory charge. He asked that Mr. Johnson inquire into that issue and provide guidance to the board.

MR. JOHNSON suggested that setting the rate from time to time would not run afoul of the diminution clause, but he could not say that definitively because in 1987 there was a court case, Sheffield v. APEA, which was based on a statute that provided for changes in the actuarial rates for purposes of calculating early retirement benefits. Although the statute stated that the actuarial rates could change from time to time, the Supreme Court ruled that it was diminution when the rates were changed in a fashion that would affect someone's early retirement basis. The court concluded that to hold that employees have a right only to early benefits, which are subject to actuarial changes until retirement, would vitiate Alaska's constitutional protection of accrued benefits for those employees who anticipate early retirement. There is, therefore, a warning from the court that changes, although there is some warning of it in the statutes, could create a diminution problem down the line. He understood this situation is an assignment of an interest rate that can be done on an annual basis and it will not affect someone's benefit. This is unlike the Sheffield v. APEA case because, as the court said, "two employees who worked for the State for 25 years and plan to retire at age 50 and who have relied since 1972 on receiving 70% of normal retirement, one of these two was born in 1930 and the other in 1931, the first gets his relied upon 70% and the second gets his expectations dashed and gets 3% less from an actuarial standpoint." He felt that if the interest rate were adjusted in a fashion that had some effect upon

employees an argument could arise. In this situation he believed interest changes would be supported and it would not be a diminution in benefits.

MR. WILLIAMS asked if this rate comes into effect only if someone wishes to withdraw their contributions or is there another implication. MS. CARPENTER explained that once an employee applies for retirement, the member contribution account balance is transferred to the Division of Retirement and Benefits to pay the retirement benefits, so the retiree no longer has the ability to withdraw the funds.

MR. TRIVETTE asked if the previous rate was set in statute or regulation. MR. JOHNSON replied that it was set by regulation. The law now does not require that it be set in regulation but that it be defined on an annual basis.

MR. BADER explained that after examination, the staff recommends that the rate not be changed. This recommendation is based on the fact that inflation over the last 30 years has averaged 4.41% and has been declining; other pension funds appear to use a wide range of crediting rates, beginning at 0%. Staff found that the crediting rate of 4.5% is reasonable.

Resolution 2006-20

MR. WILLIAMS moved Resolution 2006-20. MS. HARBO seconded.

By roll call vote, the motion PASSED unanimously.

17. SBS Asset Allocation

Resolution 2006-21

GARY BADER explained that Mr. Barnhill with the Attorney General's Office has opined that this account should be under the auspices of the ARMB and that as fiduciary the ARMB should approve an asset allocation for this account. This account is funds that are in transit. They are collected and may sit in a state account pending transfer to institutions that are investing SBS accounts. The Commissioner of Revenue has set investment in the cash account as the asset allocation for these funds. The staff recommends that the ARMB use investment in the cash account as the asset allocation for this fund. Resolution 2006-21 adopts this asset allocation recommendation.

MS. HARBO moved Resolution 2006-21. MR. TRIVETTE seconded.

By roll call vote, the motion PASSED unanimously.

18. Deferred Compensation Plan – Common Trust

MR. BADER stated that in April 2006 the ARMB adopted Resolution 2006-18 that approved a policy authorizing pooling of assets in common trusts for investment options offered by T. Rowe Price. T. Rowe Price is manager of a small cap trust fund that is offered to the Alaska Supplemental Annuity Plan and the Alaska Deferred Compensation Plan. This trust will be offered in the Defined Contribution Plan for PERS and TRS. Staff has renewed a contract with T. Rowe Price that provides for the continued use of the common trust for the small cap fund. Resolution 2006-18 focused on the Supplemental Annuity Plan and the Alaska Defined

Contribution Plan, but not to the Alaska Deferred Compensation Plan. For clarity and consistency, the staff recommends that the ARMB approve and ratify the action regarding pooling of investments in common trust to be authorized in Resolution 2006-18 in reference to the Alaska Deferred Compensation Plan.

MR. TRIVETTE moved that the ARMB approve and ratify the actions taken regarding pooling investments in common trust for the Alaska Deferred Compensation Plan as it was specifically authorized under Resolution 2006-18 with respect to other plans. MS. HARBO seconded.

MR. TRIVETTE asked if this action is appropriate from Mr. Johnson's perspective. MR. JOHNSON replied in the affirmative.

There being no objection, the motion PASSED unanimously.

19. Cornerstone Apartment Fund

MR. BADER explained that the ARMB is invested in a Cornerstone Rotational Value Fund, a closed-end commingled fund that has done very well. It appears that this fund may be in liquidation mode in the near-term and will be completely liquidated over the next two years. Cornerstone is offering another fund targeting apartment development opportunities located primarily in barrier-to-entry markets. Staff believes this is an attractive investment for the ARMB. The fund will be a \$750 million fund with \$300 million of equity. It will be 60% to 65% leveraged, have a 7 year duration and a target return of 10.5% net of fees or 12% gross. Cornerstone has a history of exceeding their targets. Apartments are attractive given that rising interest rates will make home buying more difficult and the echo baby-boomer generation will find purchasing homes more difficult as they set up new households. MR. BADER noted that the ARMB would be investing with a known partner and Cornerstone has a good track record in this strategy. From 2001 to 2005 the time-weighted net return for this manager is 33.2% for other funds with similar strategy.

MR. SEMMENS moved that the ARMB authorize staff to invest up to \$55 million in the Cornerstone Apartment Venture III subject to staff and legal counsel satisfaction with the final legal documents. MR. PIHL seconded.

CHAIR SCHUBERT asked what Cornerstone's mandates were when they were hired by the ASPIB. MR. BADER replied the first mandate with Cornerstone was a separate account mandate and that still exists. It came on the heels of the implosion of PM Realty. Cornerstone and LaSalle were hired at the same time. In September of 2005 the Rotational Value Fund was added, along with several other closed-end funds.

MR. SEMMENS asked if the ARMB would be at risk above the \$55 million it invests, given that this fund is 60% leveraged. MR. BADER replied that the fund would be at risk by losing its equity, but the properties would be the security for the fund. MR. SEMMENS asked the meaning of "rotational market." MR. BADER explained there are certain markets that are highly subject to the economic cycle. The rotational strategy attempts to enter those markets when they are distressed and then, when the economy recovers, the properties are sold. This manager goes into markets that do not have high barriers, but the proposed fund will be in barrier-to-entry markets.

By roll call vote, the motion PASSED unanimously.

20. Actuary Cash Flow Report

GARY BADER stated staff has been examining the impacts on the fund of changing its status from a defined benefit plan to a defined contribution plan where no new members are being added. The question is how long will the plan last and does this affect the asset allocation of the funds. Staff asked the actuary to opine on the long-term outlook for the fund. The assumption is that the systems will continue to be funded. If that assumption is incorrect, then the calculations based on that assumption should be revisited.

If TRS is closed and there is no additional infusion of money into TRS, the actuarial projections are that the funding ratio continues to drop over time and the TRS system would run out of money in 2024. The PERS system would run out of money in 2028. MR. BADER suggested it is important to examine the liquidity the fund must give up now to get excess returns because that will be surrendered at some point in the future. There should not be investment in commingled funds such as the Cornerstone Rotational Value Fund that has an anticipated life of seven years because there would not be money to pay benefits. Therefore, this situation would affect asset allocation. The assumptions and everything embedded in the asset allocations the ARMB has done are predicated that the system will be funded over time.

MR. BADER stated that if the actuarial rates of return are met, the fund will exist for quite a long time and will not even peak in terms of assets under management until sometime between 2025 and 2028. He thought it was important to provide this information to the ARMB. He expected that the system would be funded in some fashion either through the legislature, increased contribution rates, increased earnings, or other devices and did not recommend changing the asset allocations or modifying the strategies at this time.

COMMISSIONER NORDSTRAND noted that HB475, which did not pass, had a provision that the employer contribution rate be paid on all payroll, not just on those members of the Defined Benefit Plans. He asked if the analysis Mr. Bader has presented presumes a declining roll of members as people move into retirement or is it based on total payroll. MR. BADER believed that the analysis assumes that the rate is assessed on the entire payrolls, but that the contribution rate is not set up to the actuarial rate. COMMISSIONER NORDSTRAND noted that the actuary has not yet looked at the fact that the number of defined benefit retirees will decline. The 21% or 28% for TRS members who will enter the Defined Contribution Plan next year will be applied against their payroll. MR. BADER also did not know how that would change the assumptions. He stated the reason for this inquiry was to assess whether something should be done with respect to the asset allocation.

MR. PIHL asked for the status of the actuary's work. MS. CARPENTER stated the draft evaluation and supplemental evaluation are in final review and then will be provided to GRS for their final review. She expected everything would be completed by the end of the month and then the drafts would be delivered to the ARMB.

MR. TRIVETTE appreciated the staff's presentation, but agreed with Trustee Nordstrand that it is necessary to know whether these figures are based upon the entire pool or only the current Defined Benefit members. COMMISSIONER NORDSTRAND thought the Legislature believed the rate was based on the entire payroll, but the law did not accomplish that. MR. JOHNSON added that AS 39.35.270 says "the amount of each employers' contribution shall be determined by applying the employers' contribution rate, as certified by the board, to the total compensation paid to the active employees of the employer for each payroll period." COMMISSIONER NORDSTRAND stated that HB475 and the analysis by the Department of Law determined that the bill had to be amended in order to accomplish that goal.

MR. SEMMENS remarked that from an employers' standpoint it would be difficult to use three different rates, one for PERS, one for Defined Benefit members and one for Defined Contribution members. MS. CARPENTER clarified that there are two different plans and the normal cost rates for the incoming Defined Contribution incoming employees are different than for the current Defined Benefit employees. Having three different rates is a situation that cannot be avoided.

MR. TRIVETTE understood that different rates would not be charged across the board for the time being. COMMISSIONER NORDSTRAND replied that until the law says that can be done, it will not be done. He noted that to not be able to do that in the long-term is problematic. As people are moved out of the system as they retire and there is no one left against which to assess the new rate, there is ultimately a big problem. At the end of the day, the issue is an employer's liability to fund the pensions of its employees. There are a variety of ways to do this including the employer putting funding into the pension fund or charging a rate against payroll.

MR. SEMMENS agreed with Trustee Nordstrand's comments and was concerned because he thought the actuaries should be able to compute the employers' liability and the rate required to amortize that liability over time, including a projection for new employees, rather than forcing employers to assign various rates. He hoped that a rate that applies across the board could be achieved rather than using different rates because the normal cost rates are different.

MR. PIHL stated that the fact the Legislature did not adopt the recommendations made by the ARMB in its report gives him great concern. He believed the ARMB should express its concern in this regard through formal action. Without adopting those recommendations, the problem will continue to grow.

MS. HARBO agreed with Trustee Pihl's remarks. When the Legislature developed SB141 they intended to "stop the bleeding" from the system and that has not occurred. All of the deficits that have been analyzed assume a 100% funding ratio. The opinion from the Attorney General says that a healthy fund can be 80% funded. If the intent is to make an impact on the unfunded liability, it will be incumbent on the ARMB to set the rate at the actuarially calculated rate.

MR. TRIVETTE asked if Trustee Pihl wished to take formal action. MR. PIHL suggested that the ARMB express its concern that the recommendations made in its final report to the Legislature were not adopted. MR. SEMMENS agreed with communicating the ARMB's concerns to the Legislature, but perhaps that should be done after reviewing the 2005 actuarial

information and perhaps at the time the ARMB sets the rates. MS. HARBO was concerned that the actuarial information is going to be available at the end of June, yet the ARMB is not meeting again until October.

MR. BADER remarked that the statute states the product from the first actuary needs to be reviewed by the second actuary before the ARMB reviews it. The intent of this section of the statute was confirmed through the office of the legislation's author. He thought it was in the ARMB's interest for there to be a second review before reviewing the information.

COMMISSIONER NORDSTRAND believed that the first actuary had presented information and the second actuary review is underway; there was a replication of 2004 and then 2005 figures as well. MS. CARPENTER clarified that Buck Consulting has presented a summary report, but the more extensive report has not been completed and presented to the ARMB. COMMISSIONER NORDSTRAND thought the ARMB was aware of the 2005 numbers from the initial report.

MR. SEMMENS was disappointed that the ARMB does not have the actuarial results at this meeting. He understood that after seeing the preliminary report presented to the ARMB in March, the final report would be available at this meeting. He stated the employers in the system need the supplemental information in order to do their financial statements. He asked that a timetable be developed that guarantees that in the future the ARMB will have this information on a timely basis. MR. BADER noted this is the initial year of this process and this year the analysis by Buck Consulting of the Mercer 2004 report was needed before they could begin their work. The DOR has met with DOA to lay out milestones and when they would occur. In the past, TRS, PERS and SPIB were able to see the valuation in March. The preliminary work by Buck was not received until March this year and that did not include the supplemental report that employers need. The actuaries are working well with one another and he expected the process to go smoothly. MR. SEMMENS had a concern for this year that the next ARMB meeting is scheduled for October and that most municipalities with a June 30 year-end will be well on their way to completing their financial statements.

MR. TRIVETTE asked that staff provide clarification in the near-term whether the information Mr. Bader presented is based on all employees or only those in the Defined Benefit plan. MR. BADER stated he is 90% sure the analysis is based on the plan as it existed on June 30, 2006, which was an open plan that includes all employees.

MS. HARBO stated that her concern is for the employers' ability to plan. She recalled that last year when the PERS and TRS did not meet in June the Administration gave a 5% increase for employers' budgets.

CHAIR SCHUBERT asked if the ARMB wished to have a special meeting before October to deal with the actuarial report.

MR. PIHL thought the only issue is disclosure of unfunded liability and if municipalities have to disclose with a caveat that it could be more or less based on the new actuarial report. If that is the case, he felt that could be done. MR. SEMMENS agreed that it is just a matter of disclosure and

that financial officers can only report the information that is available. The rate setting aspect may have more impact.

COMMISSIONER NORDSTRAND understood that the rate being set is for FY08. The FY07 rate has been set and that budget cycle would begin after June 30. It would seem sufficient time if by October of this year the ARMB sets the rate that would commence in July 2007.

MR. SEMMENS believed the rate goes into effect July 1, 2007 and noted that for a municipality that has a June 30 year-end, the budget process has not started in October, although school districts generally are involved in the budget process. Calendar year municipalities have budgets that go into effect January 1, so their budgeting processes are underway in October. He thought there should be communication to employers regarding the expectation of what the rate will be if the rates are not going to be set until October.

COMMISSIONER NORDSTRAND stated there is also a policy consideration aside from this discussion of timing. The ARMB will need to decide whether to approach the actuarial rate incrementally or in total.

MR. SEMMENS stated this is why he felt it would be good for the ARMB to have the actuarial information now in order to think about the impact of that policy decision. He expected the actuarial report to say that PERS is 32% and TRS is 42%. MS. CARPENTER stated the rate is the same as was presented in March. The only new information will be the individual employer information contained in the supplemental report. MR. SEMMENS requested that the actuary provide the rate if the past service rate were amortized over 30 years rather than the current assumption of 25 years.

21. SB141 Implementation Update

TRACI CARPENTER, Director Division of Retirement & Benefits, reviewed a list of major steps being taken in the implementation of SB141 that have been ongoing over the last six months. The employee handbook for the new Defined Contribution (DC) plan is completed and is at the recordkeeper for printing. The State of Alaska has consented to allow its eligible employees to transfer into the DC plan if they so desire. Current eligible employees with a projected vesting date of July or August have been identified and notifications will be sent to those employees next week, along with the Employee Choice Kit to advise them on the differences between the plans and other information upon which to base a decision whether or not to transfer. On July 1, 2006 the kits will be sent to all of the remaining state employees with vesting dates later than August. Employer training was held in May in three locations throughout the state on the benefits of the DC plan and on the new employer reporting tool called eReporting. A web seminar will be provided on June 21, 2006 as well.

MS. CARPENTER reported that a letter was received from the IRS that the new DC plan would be receiving tax preferential treatment. There is confidence that the entire plan will be tax qualified.

MR. PIHL asked for the rationale for an employee to switch to the DC plan. MS. CARPENTER replied that the population in question is comprised of non-vested members, that is, people with

less than five years in the system. They may be more interested in managing their own retirement accounts and would be attracted to the plan because it is portable. It is also hoped that people transferring to the DC plan would reduce the unfunded liability for employers, as the liabilities to the Defined Benefit (DB) plan would end. MR. PIHL understood there is some reliance on investing the money in the DB plan to build up the total account. COMMISSIONER NORDSTRAND stated that conversion into the DC plan would allow an employee to get the state match. Furthermore, there is a benefit to the system in terms of eliminating that employee's ongoing DB obligation and the employer contribution in PERS cannot be removed. If an employee chooses to leave state employment, the contributions to PERS goes to the new DC plan and the state provides match. The money cannot be taken from PERS. The State has allocated an appropriation this year of about \$2 million in anticipation of employees converting to the DC plan.

MR. BADER asked if the state matches what the employee contributed as a PERS member. If this is the case, he understood there would be no detriment to the system by an employee conversion to the DC plan. COMMISSIONER NORDSTRAND stated that an employee would convert their contributions to the DC plan, which is matched by the state. He noted that all PERS employers will have to decide whether they will allow conversion because they will have to produce the match when employees convert to the DC plan.

MR. TRIVETTE understood that the state allocated \$2 million for its employees but did not allocate any funding for municipal employees. COMMISSIONER NORDSTRAND was of this understanding. The \$2 million allocation is an estimate and he thought the final language was in fact that the state would appropriate whatever is necessary.

MR. SEMMENS was hoping that employers would be able to access the tools to help them evaluate whether or not allowing conversion to the DC plan is a good decision. He stated he has formulated an opinion after his own analysis, but he would like the DOA to provide information that would help employers make this decision. He stated the ultimate consideration is the savings the system and the employer would achieve by employees transferring out of the DB plan; this savings can only be assessed on an individual basis. MS. CARPENTER explained that the actuary is developing a study per employer making various assumptions about what happens when employees transfer out of the DB plan and into the DC plan. Each employer will receive a one-page summary showing the projected effect of transfers. That information is expected this month.

COMMISSIONER NORDSTRAND noted the "employer conversion election" section of the report describes three items the DOA will provide employers.

MS. HARBO asked if three accounts will be set up for an employee hired July 1: one for the DC plan, one for major medical, and one for the HRA. She was concerned about the money these new hires will have upon retirement, particularly for medical expenses. She wondered if the average amount per employer is based on the total wage base divided by number of employees or if FTE is being used. Under SB475, the universe of all employers in the state was going to be used, while SB141 speaks to individual employers. MS. CARPENTER stated there are two accounts: an individual contribution account that contains the employer and employee

contributions for PERS or TRS that are automatically transferred to the recordkeeper, and the health reimbursement arrangement account that is an employer-funded trust fund. All of the funds in the health reimbursement arrangement account will go into a single fund with separate accounting for each employee for the contributions made on their behalf. The calculations under the statutes and within the parameters allowed by federal law, will be an individual employer contribution rate for the HRA, but there is a single rate for a school district (both PERS and TRS employees) and another rate for municipalities. The rates will be determined annually and will be calculated by the Division of Retirement and Benefits and reported to the employers. The major medical operates the same as it does under the DB. A retiree medical trust fund is being established for PERS and TRS retirees. Contributions toward that fund are made by the employer and they are actuarially calculated. SB141 established a rate for the first year of operation. For FY08, that rate will be based on the actuarial assumptions. MS. CARPENTER noted that there is no requirement for a high deductible health plan in the HRA. That account will build over the employee's working years and when the employee is eligible to use it, they can use it for eligible healthcare costs. MS. HARBO asked if the 3% rate established in SB141 for calculating the amount of money based for the HRA on average payroll would vary from employer to employer. MS. CARPENTER replied that the rate is 3% of the employer's average annual payroll.

MR. BADER stated the ARMB sets the crediting rate for the HRA accounts. DOR has had discussions with the DOA on that crediting rate and the ARMB will be reviewing this in the coming year after there have been several months' experience of investment returns.

MR. TRIVETTE asked if the Division of Retirement & Benefits is comfortable that it has enough money in the FY07 budget to accomplish what is needed in the coming year. MS. CARPENTER believed the funds are sufficient for FY06 and FY07; she thought there was some carry-forward balance into the next fiscal year.

MR. JOHNSON stated regarding the discussion earlier at this meeting about the application of the rate to all active employees that footnote #5 of the Attorney General's review opinion of SB141 states, "Based on the definition of member in TRS and employee in PERS the employer contribution rates will be applied only to the base salaries and total compensation paid to members of the TRS and PERS Defined Benefit plan."

BREAK 10:23 a.m. to 10:40 a.m.

22. Attorney General Opinion Letter

MIKE BARNHILL, Assistant Attorney General, Department of Law, noted that the ARMB compiled a list of 13 questions that it relayed to the Attorney General's office in March regarding the ARMB's authority, in particular vis-à-vis the Department of Administration (DOA). Mr. Johnson, he and Virginia Ragle of his office have been working on an opinion to respond to those questions. He stated that the DOA is responsible for administering the retirement systems and the ARMB is responsible for managing the money and setting the employer contribution rates.

CHAIR SCHUBERT thought that when SB141 was being put through the intent was to consolidate the assets and liabilities in one super-board. That does not seem to be what

happened. She stated it seems that the ARMB is really a reconstituted ASPIB. She did not know if Mr. Barnhill's opinion goes against the Legislature's intention in passing SB141. MR. BARNHILL responded that whenever legislation is introduced there will be many varying expressions of intent. An intent was expressed during the development of the legislation to create a super-board, but at the end of the day and after multiple drafts, the DOA was given the responsibility for managing the systems, not the ARMB. With respect to whether there was an intention to make the ARMB a reconstituted ASPIB, he felt there are differences, but there are similarities. MR. JOHNSON stated the additional responsibility of the ARMB is the setting of rates, which the ASPIB did not have. With respect to legislative intent, he suggested language in relation to question 6, which asks "Does the Board have fiduciary responsibility regarding expenditures from retirement system funds?" The language he has suggested be added is, "While discussions during the legislature's consideration of SB141 may have suggested a specific proactive role in this area by the board, the legislation as adopted does not specifically so provide. The board is empowered to 'assist in prescribing policies for the proper operations of the systems,' but we do not believe this provision imposes more than a consulting relationship." MR. BARNHILL stated his opinion is in draft form; it has been reviewed and commented upon by individuals inside and outside of his office. He indicated that there are additional comments from Mr. Johnson that will be incorporated into the opinion.

MR. BARNHILL began with a review of **question 1** "Does the Board hire the primary actuary, or have a role in the procurement process?" The initial response was that the ARMB hires the primary actuary. After closer review, it is clear that both the DOA and the ARMB have the power to hire an actuary. In SB141 it is explicit that the ARMB reports to the legislature regarding the actuarial services it had purchased. The DOA also has the authority to hire an actuary. MR. BARNHILL noted that he has had the benefit over the last months of reviewing several years' worth of correspondence between the prior actuary and the DOA and he was aware that the DOA continues to need actuarial work. Because the legislature recognized the need for the DOA to have an actuary and for the ARMB to have an actuary, the legislature required for the ARMB to coordinate with the DOA in having actuarial evaluations done of the system. This coordination can occur in a variety of ways, one of which is through a joint RFP in which the DOA takes the lead or there be joint lead. There is so much overlap, it is important to hire the same actuary in order to avoid unnecessary confusion. If the ARMB and DOA want to enter into separate contracts with the single actuary, that can be done.

MR. TRIVETTE asked if this Attorney General's opinion would be shared with the public. MR. BARNHILL replied that this draft opinion is public. He did not believe the opinion would substantively change in its final form. MR. TRIVETTE asked whether where there is explicit authorization and implicit authorization the difference is negligible. MR. BARNHILL stated the authority of the DOA to hire the actuary comes under the clause that states "the administrator is authorized to contract with public and private entities to provide ... other functions necessary for the administration of each plan in the system." The Attorney General finds that the actuarial function is necessary for the administration of the system; therefore, the DOA has the explicit authority to hire an actuary.

MR. BADER asked if the conclusion that the DOA and ARMB should hire the same actuary is a legal conclusion or a best practices conclusion. MR. BARNHILL replied that it is a legal

conclusion because the legislature used the word “coordinate” and it is also a best practice conclusion. He did not imagine that from either a legal or a best practices perspective the Legislature intended to give the DOA and the ARMB authority to hire two separate actuaries.

CHAIR SCHUBERT asked whether the actuary reports to the DOA or to the ARMB. MR. BARNHILL replied that could be largely a function of the contract structure. Currently, the contract is between the DOA and the actuary, so contractually the actuary reports to the DOA. If the parties wished to have the actuary report directly to the ARMB on items such as rate setting and valuation of liabilities and to the DOA on all the administrative actuarial functions, that could be done.

MR. SEMMENS stated the current situation is that the DOA is reviewing the actuarial information and he could only speculate that if the actuarial contract was with the ARMB, that situation might be different. Under the current situation the matter is out of the hands of the ARMB.

CHAIR SCHUBERT felt it would be cleaner to amend SB141 to clearly delineate this issue. She stated the legal opinion creates confusion in her mind. She asked why this language was drafted as it is in the legislation. MR. BARNHILL believed that the language was proposed as it is because the Legislature recognized there were various actuarial functions and two entities for which the functions must be performed and that it would be easier to have one actuary. He thought it is relatively straightforward for the issues to be apportioned between the DOA and the ARMB. This can be done through a memorandum of understanding or by verbal understanding. CHAIR SCHUBERT noted that the language creates a responsibility in the ARMB without real power. MR. BARNHILL did not agree with this assessment. He felt the ARMB has the power to hire an actuary, as does the DOA, the ARMB and DOA simply have to work together.

COMMISSIONER NORDSTRAND stated that based upon this opinion it seems there should be a joint contract where the functions that are supervised by the ARMB, such as rate setting, are identified. He had no objection to the actuary reporting to the ARMB on the things over which the ARMB has supervision. He noted that there are all manner of things involved in administering the plans that could require actuarial advice and the DOA will contract for and obtain advice, as necessary. He did not find this confusing and thought the responsibilities could be clearly delineated.

MR. PIHL felt the situation is one of the DOA and ARMB working together. He did not know why the ARMB was not more involved in hiring the actuary. He asked how long the DOA has had the draft actuarial report and why the ARMB did not have that report, which would have answered many of the questions that have been posed. He felt the ARMB should be in consultation with the DOA in hiring the actuary and the ARMB should have draft actuarial reports.

MS. MILLHORN stated it is important to give the DOA an opportunity to review the draft and supplemental reports and make any necessary corrections before it goes to the ARMB trustees. Those revisions and corrections have been made and are incorporated in the draft. In regard to

assembling a PEC for the hiring of the actuary, while no ARMB member was included, that could be done in the future. An employer was on the PEC, as was Gary Bader.

MR. BARNHILL proceeded to the **question 2** “Does the Board approve the assumptions the actuary uses, if there is any latitude?” In answer, he stated that the ARMB does approve the assumptions the actuary uses. The ARMB has to periodically review the assumptions with the assistance of another actuary and if that other actuary recommends changes to the assumptions, the ARMB is empowered to direct the primary actuary to make those changes. The ARMB will approve the actuarial assumptions upon which it relies in setting employer contribution rates.

MR. TRIVETTE thought this question came from some of the hearings on SB141 where some implied that the previous board should have questioned the actuarial assumptions. The question is if the ARMB has the legal authority to direct the actuary to set the rate to something other than it is recommending. MR. BARNHILL stated the legislation directs the ARMB to review the assumptions with the assistance of expertise. If the ARMB finds itself with two conflicting opinions regarding assumptions and is unable to make a decision, the ARMB has the authority to contract for additional expertise.

COMMISSIONER NORDSTRAND asked if it is correct to state that the limits of the ARMB authority to question the assumptions relate to the fiduciary obligations to the trusts. He felt there was a distinction between doing that and simply choosing a different assumption in order to achieve a different result. MR. BARNHILL replied that everything the ARMB does has to be consummate to the discharge of its fiduciary obligation. MR. JOHNSON stated that it is standard in court review of actions taken by administrative bodies that decisions are based on the materials presented and on a reasonable basis. He suggested adding language to the opinion that states “Case law in Alaska and elsewhere holds generally that revisions to assumptions or funding status which arise from reasons not related to prudent behavior and in the specific best interest of the pension funds would be suspect.”

MR. BARNHILL next responded to **question 3** “Who decides when and how much money is spent in additional actuarial analysis?” He stated the DOA manages the systems, the ARMB manages the money and sets the rates, and the Governor and Legislature develop the budgets. The ARMB has a role in the budget preparation process and will engage in that role with the DOR staff. He imagined the DOA will also have a role in that budgeting process. If the ARMB feels that additional actuarial analysis is needed and it has not been budgeted for, the ARMB can either seek supplemental appropriation or include it in the budget for the next fiscal year.

MR. BARNHILL responded to **question 4** “Does the Board and/or the administration have authority to sue the previous actuary for its advice?” MR. BARNHILL stated the Attorney General has the authority to file a lawsuit on behalf of the State of Alaska. The Attorney General consults with his clients and the Governor’s Office for advice and opinions regarding whether a lawsuit should be filed.

COMMISSIONER NORDSTRAND clarified that the traditional attorney/client relationship is a little different with the Attorney General in that the Attorney General has many lawyers that represent boards and commissions, but for litigation purposes, the Attorney General is the final

authority on the decision to settle or to try a case. MR. BARNHILL noted that Alaska subscribes to the strong Attorney General model.

MR. BARNHILL responded to **question 5** “Does the Board have discretion to set a rate for the Naval/Militia system to fully fund that system?” MR. BARNHILL stated the ARMB has the discretion to set a rate to fully fund the systems for which it sets rates, but he was unsure if the question was asking whether the ARMB has the discretion to set a rate less than one that would fully fund the system. To the extent that question was implied, the opinion indicates the ARMB has some discretion to set the rate that does not fully fund the system, but that discretion is limited. There is case law and Attorney General opinion that setting a rate to fully fund a system can become a vested right to those invested in that system. In the context of the Naval/Militia System, there is not an historical experience of rates that fully fund the system. The system has been funded from 17% in 1994 to 90% in 1998; he was not aware of the funding level today. In reviewing materials the previous actuary sent to the boards, there was frequent reference to the notion that an 80% funded system is a healthy system. In that light, it would be inadvisable to set a rate for the Naval/Militia system that goes below that. He noted that the funding for that system comes out of the DMVA budgets and is subject to annual appropriation by the Legislature.

MS. HARBO noted that in SB141 the Legislature wants the ARMB to fund at 100% to get rid of the unfunded liability. MR. BARNHILL stated it is clear that the legislation requires that normal cost rates be set to fully fund normal costs. That requirement does not exist with respect to past service costs.

MR. SEMMENS stated that the legislation, as he reads it, says the assets must be managed sufficient to meet the liabilities of the system. From an accounting standpoint, that is different than cash flow. The actuary says what the liabilities of the system are, so the issue becomes over what period of time the liability will be met. Strictly read, managing the assets to meet the liabilities is impossible today because the system has a \$6.9 billion deficit. He did not think the legislative language allows a great deal of flexibility. He believed the ARMB is tasked with setting the rates to meet the liabilities and, for each employer, to set a rate to meet the past service liability. MR. BARNHILL disagreed that SB141 requires setting rates to fully fund past service costs. Because the Legislature said the ARMB has the obligation to set rates to fully fund normal costs, but did not use that same language with respect to past service costs, the ARMB has some discretion to set rates for past service costs. He did not believe there is discretion to set a minimum rate with respect to past service cost. The Attorney General’s office said the rate must be adequate. Mr. Johnson cited 2003 legislation from Washington requiring that rates have to be set to pay interest on past service costs. He thought the Alaska Supreme Court would not go so far as to say that only interest should be paid. At the end of the day, there is probably an obligation for the ARMB to set a rate so the system is healthy. There is some discretion, but if the ARMB is contemplating setting a rate that does not create a healthy system, there should be discussion of the potential liabilities.

COMMISSIONER NORDSTRAND felt the question is what is meant by meeting the liabilities. At its most extreme it means to send a bill to everyone. The other extreme is to incrementally pay it off over some longer period of time. He did not think that the requirement to meet the liability means that the ARMB has to accept the actuarially recommended rate.

MR. JOHNSON stated that the ARMB mandate includes the language “Consistent with the standards of prudence, the board has the fiduciary obligation to manage and invest these assets in a manner that is sufficient to meet the liabilities and pension obligations of the system, plan and program.” This language relates to the ARMB’s responsibility with respect to the assets over which it has custody. In a different provision is a discussion of the ARMB’s rate setting responsibilities. The language is “the employer contribution rate may not be less than the rate required, after subtracting the member contribution rate, to fully fund the actuarially calculated benefits expected to be earned by active members during a fiscal year.” There is not an absolute symmetry in the legislation with respect to the ARMB’s managing and investing responsibilities and its rate setting authority.

MR. BARNHILL responded to **question 6** “Does the Board have fiduciary responsibility regarding expenditures from retirement system funds? If yes, to what extent?” MR. BARNHILL stated that in general, the answer to this question is “no.” The DOA has the fiduciary obligation to manage the liability side of the retirement systems. The ARMB has, with respect to its budget, fiduciary obligations regarding expenditures including money manager fees, consultant fees, and actuarial fees. The ARMB has the role of assisting the DOA in prescribing policies for the administration of the system. To the extent the ARMB has views on expenditures being incurred by the system, it can express those. MR. JOHNSON reminded the ARMB that in a previous memorandum to the ASPIB he described the relationship between ASPIB and DOA as a dynamic tension. The ARMB is an integral part of the system and the DOA, as the administrator of the system, has an obligation to the ARMB. In that respect, the ARMB’s role has to be recognized and that should give some context to the concept of coordination and assisting.

MR. SEMMENS noted that if not asked to assist, his staff does not assist him. In the same respect, if the Commissioner of Administration does not ask for assistance, the ARMB is excluded from the system. He asked if the DOA has a duty to ask for assistance and, if so, to what extent. He explained that as a trustee he would like to know if policies are going to be established before they are finalized. MR. BARNHILL replied that at a certain level this stops being a legal discussion and instead is a discussion about how the entities work together. The ARMB could unilaterally offer assistance to the DOA and it is the DOA’s discretion whether or not to accept it. MR. SEMMENS noted that the ARMB has not been asked to assist in developing the new health plan; that is apparently under the purview of the Commissioner of Administration. He personally felt that is something with which he would have liked to assist. MR. BARNHILL stated that legally the ARMB has the authority to assist and the DOA has the authority to do without the ARMB assistance.

MR. TRIVETTE understood that the only responsibility the ARMB has to is to avoid materially imprudent expenditures on board related matters regarding the management of invested assets. If the ARMB becomes aware of something it deems imprudent, it can only be involved with regard to how that impacts investments. MR. BARNHILL did not believe this was accurate. He stated that if there is malfeasance and the ARMB detected that, it would have a fiduciary obligation to say something about it. In terms of questions 6, 7 and 8, if the ARMB finds that retirement funds are being spent for General Fund matters, for instance, it has an obligation to speak up about that.

COMMISSIONER NORDSTRAND stated that the ARMB's report to the Legislature incorporated certain ideas the ARMB had with regard to healthcare costs; those were considered by the DOA and suggestions were incorporated.

MR. SEMMENS asked for explanation of the sentence in answer to question 6 "This includes funding for Board activities which are a part and parcel of the costs of the system." He read that to mean that the DOA has authority over the ARMB budget. MR. BARNHILL stated that by statute the expenses of the Board are paid for out of the retirement systems. To the extent the DOA thinks the ARMB is mismanaging its expenses, they have a fiduciary obligation to speak up. All of the entities have some fiduciary obligation and role with respect to the retirement systems. MR. JOHNSON stated the point in this language is that the ARMB is an integral part of the system and, to the extent the DOA is administering the system, the administrator has an obligation to seek funding for the ARMB to carry out its duties and functions. He submitted that it would take a determination by the DOA that somehow the ARMB was acting improperly in carrying out its mission, in terms of expenditures, for them to refuse, for example, to submit budgets on the ARMB's behalf.

MR. PIHL stated a budget committee worked with Mr. Bader's office to develop a budget for the ASPIB and he presumed the practice would be the same with the ARMB.

MR. SEMMENS stated the law says that the ARMB will prepare an annual operating budget.

COMMISSIONER NORDSTRAND stated this is an issue of from where the money comes once the budget is established. MR. BARNHILL thought question 6 goes more to the overall expenditures out of the system. The ARMB has fiduciary responsibility to produce its budget. MS. TAYLOR stated it is helpful to read the context of the legislation; when she first read it in practical terms it seemed that when she is compiling budget information she would review it with the DOA and get its approval. The actual language does not seem to refer to the expenditure of the funds from the system. She was not sure the intention was to require coordination with the DOA to review the ARMB budget. She was aware from previous internal discussions that the State Comptroller worked with the ASPIB Budget Committee on the ASPIB budget; she presumed that process would continue with the ARMB. She did not believe the process would go through the DOA before it got to the ARMB Budget Committee. MR. JOHNSON added that the funds for the ARMB operations are coming from the retirement funds and the administrator has involvement in that respect.

MR. BADER understood the language in the legislation speaks to expenditures being paid by the system. He thought the following sentence that speaks to the DOA creates confusion because it implies there is some kind of oversight role for the DOA in the ARMB budget. MR. BARNHILL noted that this opinion is still in draft. MS. TAYLOR suggested the language could be modified because several individuals had the same reading of that language as Mr. Bader. MR. BOUTIN did not know there is a difference between the budget responsibilities of the ARMB versus those of the Alaska Housing Finance Corporation (AHFC), Knik Arm Bridge and Toll Authority (KABATA), and others, but it looked to him that the DOA has operated with ASPIB and now with the ARMB as if those board responsibilities are the same from one independent board to the

next. MR. WILLIAMS understood the issue is if it is implicit in the Attorney General's opinion that because the ARMB is set up in the DOR, that the DOR has the responsibility for the development of the budget, which is the case with the other boards. MR. BOUTIN stated that some of the other boards, including AHFC and the Alaska Permanent Fund Corporation (APFC), are in the DOR and he was not aware of a distinction of other independent agency boards from the ARMB and the others do their own budgets. COMMISSIONER NORDSTRAND stated those other boards do not find their funding in another department, there is simply an RSA between departments. In the case of AHFC, that agency does not have funding in another department for its operation. In this case, the function sits in DOR and it is completely independent, as is the ARMB, but in order to pay expenses, the money has to come out of the fund and the plan administrator has to build that into the budget. MR. BOUTIN stated that the other entities also do look to other departments for funding; he did not think there is a distinction between AHFC and the ARMB and APFC. Each board is independent and each board is established in a particular department. The Executive Budget Acts applies equally to AHFC and the ARMB and he did not see a distinction between the two. MR. BARNHILL stated the fact that the ARMB is located in the DOR is not particularly determinant. There are two issues. One issue is the fiduciary obligations the various entities have with respect to expenditure of funds out of the system. The second issue is the budgeting process for the ARMB. He thought the DOR was wondering how the DOA fits into the budgeting process for the ARMB; he believed the DOA may have a small role in the budgeting process, but as a fiduciary it has a role to oversee expenditures out of the funds. MR. PIHL understood Mr. Barnhill comments to be that the DOA is a super agency over the ARMB with respect to expenditures. MR. BARNHILL clarified that the DOA has an independent fiduciary role with respect to expenditures out of the funds. MR. BADER thought the DOA Division of Finance has oversight responsibility for every state agency and budget. He sensed that the language is intended to be no more than the normal operations of the DOA. MR. BARNHILL agreed with this assessment.

MR. BARNHILL next responded to **question 7** "Expenditures of retirement system funds are made from various State budgets. Can the Board require the Departments of Revenue and Administration to provide the trustees with the budgets that they intend to submit?" He stated this is more a function of how all of the entities work together. The Attorney General does not think the ARMB has the statutory authority to require the DOA and DOR to provide their budgets, but if there is a cooperative working relationship among the three entities, some accommodation can be made to ensure the ARMB gets the information it feels it needs.

MS. TAYLOR thought this would be very different than the other independent corporations established. It would be incomprehensible that staff would prepare a budget for the APFC, for instance, that did not go through the board of trustees. She asked whether in this instance, staff could prepare a budget with funding sources from the pension systems and conceivably forward that to the Governor and Legislature without any oversight. MR. BARNHILL thought the question was whether the ARMB has the right to require the DOA to submit their Division of Retirement & Benefits budget for review. He felt the answer to that question was "no." There is also the like question whether the ARMB has the right to require the Division of Treasury to submit its budget. He felt the answer to that question was "no." MS. TAYLOR understood that the only oversight that the ARMB has over the expenditures from the pension funds is meeting costs and travel costs. MR. BARNHILL stated there is also oversight regarding investment

manager fees and consultant fees and expenses ancillary to managing. MR. WILLIAMS noted that the Division of Retirement and Benefits (DR&B) has costs that are ancillary in that same regard that it allocates back against the retirement benefits. He asked if that is the purview of the ARMB purview or the fund administrator's costs. MR. BARNHILL believed if there are fees, such as health insurance or consultant fees, those go in the DR&B budget and are subject to their approval and not the ARMB. MR. SEMMENS noted the practical problem with interpretation is that those expenditures have an impact on how the ARMB sets rates. He understood that the Commissioner of Administration could change the existing plan, which is an incredible amount of power vested with one person. The Commissioner could increase the health plan such that the plan incurred incredibly more expenses than were anticipated in the actuarial valuation. Under the interpretation being presented, the ARMB would have no ability to even know about that until after the fact. He found that amazing and disconcerting. MR. JOHNSON thought the answer to the question, as presented, was based on a literal assessment of the question and an emphasis on the word "require." The focus of the interpretation was on the authority of the ARMB to issue a writ and require something be done within the context of the fiduciary responsibilities of the various parties.

COMMISSIONER NORDSTRAND stated this question is about approval of a department budget, whereas Trustee Semmens is talking about the role of the plan administrator in changing something in the plan that would have the effect of increasing the cost of the system. The statute is set up so that the plan administrator can occasionally unilaterally make changes to the plan. MR. SEMMENS indicated that he did not intend to personalize the question, but only wished to indicate that the Commissioner of Administration has the authority to change the plan and those changes impact the ARMB. He felt it was appropriate for the ARMB to be apprised of such changes. COMMISSIONER NORDSTRAND stated the only place those decisions would be reflected in the budget is in some prospective adjustment, for example, to premiums charged to the retiree or active medical plan. That cost would not show up as a line item in the budget, rather the premium would change and that would be reflected in the cost of the system and be charged back to the PERS and TRS, and in the active plan it would be charged back to the agencies' budgets.

MR. BARNHILL acknowledged Trustee Semmens's concerns, but noted that there are many steps in the budgeting process and many opportunities for the ARMB to voice its concerns. The ARMB has a fair amount of clout in the Legislature and, if it raised concerns with respect to certain expenditures, he believed its voice would be heard.

MR. WILLIAMS felt Trustee Semmens's remarks were in the context of question 6 and were not general budget questions.

MR. BARNHILL next responded to **question 8** "It is clear that the legislature and the Governor set the budgets, but does the Board have responsibility to insure that cost allocations are appropriate, that expenditures charged to the retirement systems are appropriate, and that fees charged [by] investment managers are reasonable?" MR. BARNHILL stated the question did not specify what cost allocations were of interest to the ARMB. There are cost allocations within the Division of Treasury and DR&B between General Fund work and retirement system work that is done by the same staff. There are cost allocations between the PERS and TRS and other

retirement funds. His response addresses both types of cost allocations. He stated the response goes to how the executive branch prepares and approves budgets for submission by the Governor to the Legislature. If the ARMB feels there are cost allocations that are inappropriate, that can be expressed. At the end of the day, the Governor chooses what budget to submit to the Legislature.

MR. BARNHILL next responded to **question 9** “If the Board does not agree with the way that systems resources are being spent, what recourse does the Board have? If none, how can we be responsible for managing the assets and liabilities of the retirement systems?” MR. BARNHILL stated if the ARMB disagrees with what is being done, it has a First Amendment right to speak. This can be done at various levels in the DOA, in the DOR, within the Governor’s office, and at the Legislature. To the extent the ARMB thinks there are serious legal issues, it can go to the Department of Law or to Mr. Johnson and request legal assistance.

MR. BARNHILL next responded to **question 10** “Does the Board have any responsibility to approve the Tier 4 health plan?” MR. BARNHILL was unsure what was meant by the Tier 4 health plan, but in general, this is the responsibility of the DOA and not the ARMB.

Question 11 “Does the Board have any responsibility to approve any changes to the existing retiree health plan?” MR. BARNHILL stated this responsibility lies with the Commissioner of Administration or his designee.

Question 12 “Does the Board have authority to establish regulations affecting the administration of the retirement systems?” MR. BARNHILL stated Mr. Johnson’s provided comments emphasizing that the ARMB has regulatory authority in certain contexts, such as in the SBS, with respect to items directly under its purview, but in terms of establishing regulations that affect the administration of the systems, the answer is “no.” The Commissioner of Administration is given explicit statutory authority to establish regulations for the administration of both the PERS and TRS. The administrator of those plans is given explicit statutory authority to recommend regulations for approval by the Commissioner. The ARMB, unlike the old PERS Board, does not have the authority to prescribe policies for administration of the plan; it has authority to assist in the prescribing of those policies.

Question 13 “Does the Board have any authority in approving or disapproving regulations affecting the retirement systems which are promulgated by the Commissioner of Administration?” MR. BARNHILL stated the ARMB has the authority to assist in promulgating regulations.

MR. TRIVETTE asked when the Attorney General’s opinion might be re-issued. MR. BARNHILL replied that some changes will be made to the paragraph dealing with budgeting responsibilities and authorities. He anticipated his opinion could be finalized in the timeframe the ARMB desires. MS. HARBO thanked Mr. Barnhill for the time he invested into the opinion, which she found interesting and informative. She felt the opinion lends clarity to some of the things the ARMB can and cannot do. CHAIR SCHUBERT also thanked Mr. Barnhill for their work in and stated this is a good work product. MR. BARNHILL thanked Mr. Johnson and Ms. Ragle for their work.

23. Investment Advisory Council Finalist Interviews

MR. SEMMENS, Chair of the IAC Selection Committee, stated the Committee met twice in May and reviewed nine applications that met minimum qualifications. Four candidates were selected among those nine for interview. Those individuals were interviewed and three of them have been brought to the ARMB for final interviews. The qualifications of this seat, Seat 1, is that the “candidate shall possess experience and expertise in financial investments and management of investment portfolios for public, corporate, or union pension benefit funds, foundations or endowments. Preference will be given to candidates with a minimum of 10 years experience as a manager/director or trustee of a pension or public fund of \$10 billion or more in market value.”

CHAIR SCHUBERT asked how the interview process should be handled. MR. SEMMENS suggested using the questions posed that had been posed in the previous interview. MR. PIHL asked that the qualifications of the other two seats be briefly outlined. MR. SEMMENS stated Seat 2, currently held by Jerrold Mitchell, requires that a preference be given to candidates with a minimum two years’ experience in portfolio management of a fund of \$2 billion or more in market value. Seat 3, currently held by William Jennings, requires that the candidate shall be a professor, preferably full time, of investment theory or closely related discipline at an accredited college or university. The candidate shall possess experience and expertise in financial investments and management of investment portfolios for public, corporate or union pension benefit funds, foundations or endowments. Preference will be given to candidates who demonstrate significant experience, including a minimum of five years as an academic.”

MS. HARBO thought the ARMB should have all candidates introduce themselves within a 5-minute period. She suggested that the questions asked be the same for each candidate and that they be a selection of the questions posed at the initial interview.

COMMISSIONER NORDSTRAND asked why one of the four was not selected for interview by the ARMB and why five were not interviewed. MR. SEMMENS explained that the Committee reviewed each application and used a formal point-setting rubric, eliminating candidates based on each individual evaluation. The four candidates with the most points were selected for interview. COMMISSIONER NORDSTRAND asked if the decision was made to forward three candidates to the ARMB. MR. SEMMENS confirmed this was the process.

Tim O’Brien

MR. SEMMENS thanked Mr. O’Brien for his interest in this position and for his past service. He offered him a period of five minutes to discuss his qualifications and asked why he is interested in this position.

MR. O’BRIEN thanked the ARMB for the opportunity to be reconsidered for the position. He stated that he grew up in Chicago and lived in a traditional, large Irish-Catholic family and enjoyed a unique extended family relationship that is uncommon today. He stated it is the kind of relationship experience he wished his children could enjoy. Knowing how important other caregivers are in one’s life and the importance of that time period is in one’s life, he benefited

from others giving advice and support. He stated his grandparents emigrated from Ireland. He and his grandfather were very close. His grandfather's final job was driving a streetcar in Chicago and he received a pension from the transit authority. One of his aunts was a librarian in the school system and his other aunt worked with the Cook County health department and his father was with the police department in Chicago. So the participants and beneficiaries of pension systems are his friends, family, and colleagues. He stated he graduated college with a degree in accounting. He was initially a physics major in college and had an epiphany in the physics lab one afternoon that he would not pursue a career in that field. He took accounting courses and then took and passed the CPA exam. He went to Denver in 1972 intending to move to California and has been in Denver since. He spent six years in public accounting primarily auditing mutual funds. One of his aunts had worked with the health department for over 30 years and retired; she suggested he get experience, try different things and move around. Based on that advice he took a job with the State of Colorado as the assistant controller and then as controller at a long-term care psychiatric hospital. He was there for three years and was asked to apply for a position at the Colorado Bureau of Investigation where he stayed for one year. He called the state auditor for a position and eventually was hired. Three years later he was appointed to the position of state auditor. As a staff member in the auditor's office he was involved with auditing the state treasury and the treasury of the University of Colorado. As the state auditor from 1984 through 1995 he was a member of the board of trustees of the public employee retirement Association of Colorado. This gave him perspective of the duties and responsibilities of the ARMB Trustees. He went to work for Mercer in a position similar to the one Mike O'Leary has for the ARMB. He was there four years primarily doing investment consulting with public funds. In his work conducting fiduciary audits he was involved with funds that were experiencing some kind of difficulty. During his fourth year with Mercer he and his wife made the difficult decision to divorce after 19 years and he chose to leave Mercer at that time. Upon leaving Mercer he volunteered to step in as president/CEO of the American Humane Association. He was there for four years, but left because he realized he did not have the passion required for the position. He left that position three years ago. Since that time he has been working with the State of Alaska and another pension fund in Denver, for the city and county of Denver, and sits on the board of a mutual fund in Washington D.C.

MR. SEMMENS assumed that because Mr. O'Brien is here he is still interested and committed to this position. He asked whether anything has changed since the committee meeting that would change his response to the questions that were posed then. MR. O'BRIEN replied that there have been no changes either in his written response or verbal responses at the last meeting.

MR. SEMMENS asked how he stays informed on current events in the investment world. MR. O'BRIEN stated he attends conferences, such as the Callan conference. He also attends conferences in his involvement with the mutual fund. He is a CFA member and the CFA Institute has a chapter in Colorado that conducts lunches with speakers.

MR. SEMMENS asked for more information on Mr. O'Brien's involvement as a trustee to a pension fund. MR. O'BRIEN stated he was on the board of the Public Employees Retirement Association of Colorado for nearly 12 years. He was a board member, a member and chair of the investment committee, helped start and chaired the audit committee, and served and chaired on

the asset management committee. He also participated in an ad hoc corporate governance committee.

MR. SEMMENS asked if Mr. O'Brien would be willing to take a position that is contrary to the ARMB, staff, or other IAC members. MR. O'BRIEN replied in the affirmative and noted that he has done so as a current IAC member. He noted that IAC members are hired for their individual opinions.

MR. SEMMENS noted that the ARMB will be dealing with Defined Contribution plans and asked if Mr. O'Brien has any experience with those. MR. O'BRIEN stated that with the State of Colorado he was involved in establishing the 457 plan in 1985. Three to four years later there was a provision in the statute that allowed state funds to also set up 401(k) plans and he assisted in doing that. He sits on the board of a mutual fund that provides Defined Contribution services to a number of state and local governments. He also audited the 457 plan for the State of Colorado.

MR. SEMMENS asked that Mr. O'Brien please describe his experience with investments to which the ARMB has limited exposure. MR. O'BRIEN stated that Colorado was involved in timber at an early stage and was also involved in oil and gas partnerships.

MR. SEMMENS asked if Mr. O'Brien is currently a candidate for future employment or employment with other boards and commissions that would affect his availability to the ARMB's IAC. MR. O'BRIEN responded in the negative.

MR. TRIVETTE noted that some of the ARMB members, including he, have attended past ASPIB meetings and he found that Mr. O'Brien is obviously well qualified for this position. He expressed appreciation for Mr. O'Brien's service.

MR. PIHL asked if Mr. O'Brien manages his own investments or hires out. MR. O'BRIEN replied that he uses mutual funds.

MR. SEMMENS asked why Mr. O'Brien feels he should be chosen for this position. MR. O'BRIEN responded that he has a breadth and depth of experience that is beneficial to the ARMB. He has been in and around the investment business for 35 years. He has been an auditor, a trustee, and a consultant. He has seen what has been done in other funds that does and does not work well. Secondly, he has a history with the ASPIB and now with the ARMB. During the six years he has served on the IAC, enormous change has occurred in the portfolio and those changes have been beneficial to the portfolio and to the beneficiaries; the proof is in the results, which is top quartile performance. The two-year trend of out performance is attributable to many, including himself. Lastly, he enjoys this consulting work. He is blessed in that he is doing something he enjoys. This work benefits the people who need their pensions. He summarized that he should be selected for this position based on his experience, history and passion.

MR. SEMMENS confirmed through the Board that the format of questioning was appropriate.

Pat Wellington

MR. SEMMENS thanked him for his interest in the position. He explained this interview would follow a similar format to that of the committee meeting. He asked that he discuss his qualifications and explain why he is interested in this position.

MR. WELLINGTON thanked the IAC Committee for bringing him before the full Board. He stated he considers himself to be a team player and, once a decision is made, he supports it. When the final decision was made on SB141 and the Governor signed it, he chaired the Budget Committee and encouraged that the budget be revised based on the new ARMB operations. At the June meeting after SB141 was adopted, he said he would do what he could to ensure there was an orderly transition from the ASPIB to the ARMB. He called the ASPIB Controller and offered to fly into Juneau early in order to make changes to the budget, which was based on the ASPIB, in order to accommodate the ARMB. The following day he flew to Anchorage and met with Commissioner Boutin, Mr. Bader, Ms. Martin, and Ms. Hall to revise the budget. He met with the Budget Committee in Anchorage the following day to explain those changes and the Committee agreed with those changes. While in Juneau he met with the real estate officer at the time to discuss things that should be put on hold. He tried to do what he could to facilitate an orderly transition between the two boards.

MR. WELLINGTON stated that he felt he could make the transition from being a board member to being an IAC or staff member. He was Commissioner of Public Safety under Governor Egan and was then asked by the new Commissioner of Public Safety to be an assistant and he did so. Governor Hammond later appointed him as Director of the State Troopers. His resume shows that over the years he has worked well with people. Through his many years of living in Alaska he has tried to repay the state through volunteer and paid service.

MR. WELLINGTON emphasized that what he says is what he means; he does not have opinions of convenience. He understands the role of the IAC, having served on the IAC Committee as an ASPIB member. He stated he is not coming into this position with preconceived notions or agendas. He is a risk-taker but not a gambler. He assured the ARMB that he is not coming into this position to make changes or disrupt, but because he has something to offer.

MR. SEMMENS asked if anything has occurred that would change Mr. Wellington's responses to the Committee. MR. WELLINGTON responded in the negative.

MR. SEMMENS asked how Mr. Wellington stays current on events in the investment world. MR. WELLINGTON replied that he subscribes to a number of periodicals and occasionally he reads the *Wall Street Journal* and looks at things online. He watches news programs on Fox and CNN.

MR. SEMMENS noted that the preference for this seat is given to individuals with 10 years or more experience with a pension fund of \$10 billion or more. He asked what Mr. Wellington's strengths are with regard to that preference. MR. WELLINGTON replied that his greatest strength is that he listens, observes, and analyzes matters before making a decision. He stated he is not afraid to ask questions and he is dedicated. He was a member of the PERS Board since 1978 and of the ASPIB board since 1992 and during those periods of time he missed three

ASPIB meetings and three to four PERS meetings. He served on 8 of the 10 ASPIB committees. He summarized that he is a good listener, thoughtful, and not afraid to ask questions.

MR. SEMMENS asked whether Mr. Wellington is currently a candidate for future employment or employment with other boards and commissions that would affect his availability to the ARMB's IAC. MR. WELLINGTON responded in the negative.

MR. SEMMENS asked whether Mr. Wellington is willing to take a position that appears to be contrary to that of the ARMB, other advisors including IAC members, or staff. MR. WELLINGTON replied that he would, noting that once he analyzes something he may take a different position, but once the decision is made, he supports it.

MR. SEMMENS remarked that on July 1, 2006 a new Defined Contribution plan would be implemented. He asked that Mr. Wellington describe any experience he has with Defined Contribution plans generally. MR. WELLINGTON replied that he has none. His experience was reviewing this issue as SB141 was being considered. He is a retired state employee under the Defined Benefits plan. He stated he is willing to spend the time to learn. MR. SEMMENS asked whether, in regard to Defined Contribution plans or similar plans such as 401 plans, does Mr. Wellington have experience respecting allocation, choices, education etc. of a plan different than the Defined Benefit plan. MR. WELLINGTON stated that when it became evident that SB141 was going to pass, the ASPIB looked at what type of investment programs should be offered to employees after July 1, 2006. He felt the program should mirror the SBS program and that is basically what was done. He felt that was prudent because it is a tried and true program. In addition, when he worked at Alyeska Pipeline they had a Defined Contribution program.

MR. SEMMENS stated the ARMB is and the ASPIB was presented from time to time with ideas that are cutting edge and are not or are minimally contained in the portfolio. He asked what Mr. Wellington could bring in terms of advice or experience dealing with those types of things. MR. WELLINGTON stated that when ASPIB was created there was a very limited real estate portfolio. The Real Estate Committee did a number of things to become educated on a real estate program for the ASPIB. After about one year of discussions and attending conferences, a recommendation was made. He stated he wants to review things and understand them. He was not opposed to new investments, but reiterated that he is a risk-taker and not a gambler.

COMMISSIONER NORDSTRAND asked about Mr. Wellington's concerns with SB141 before and after it was passed. MR. WELLINGTON stated that after it was passed he stated publicly at the ASPIB's June meeting that he would do what he could to implement the bill. His concern before passage was that it would have been beneficial to have more time to review the legislation. He was concerned that the bill did not include a death benefit for police and fire employees killed in the line of duty. He pointed that out three times to the Legislature and after the Special Session attended by police and firemen attended, it was included. He felt his primary concern with insufficient time for review, which was shared by some legislators as well.

COMMISSIONER NORDSTRAND asked if there was concern with consolidation of the three boards and the degree of authority of the DOA to handle things that had been done in the past by PERS and TRS. MR. WELLINGTON felt that because the 65,000 plus public employees who

are active or retired pay over \$100 million a year out of their salaries into the program, they should have a voice at the table. Two members of the PERS Board were elected and three were gubernatorial appointees. All of the TRS Board members were gubernatorial appointees. The ASPIB included two PERS and two TRS members. He felt that when people participate financially in their retirement program, they should have a place at the table, although not a majority. He was also concerned that there was an inference that the three boards did not work well together, which in his opinion was not the case.

COMMISSIONER NORDSTRAND stated he has seen the March 2005 letter Mr. Wellington wrote to the Governor stating his concerns and he thought his concerns were stronger. He wanted to be sure Mr. Wellington could work with the new board in this new system. The letter indicated that the combination of the boards would have a detrimental effect on the retirement systems and the financial stability of those systems. He understood Mr. Wellington's concern that the three boards did work well together and that there might have been misperceptions in that regard, however, he was curious how he thought the ARMB could affect the financial stability of the systems. MR. WELLINGTON stated that he was trying in that letter to point out that the system was working well and it was conceivable that by eliminating three boards and creating one new board and not giving the new board sufficient authority and responsibility to do what they needed to do could have a detrimental effect. One concern is that the ARMB does not have the authority to look at the liability side. The largest single liability in the system is medical. He understood the intent of the legislation was to give a single board the authority to look at both the assets and the liabilities. If that board does not have that authority and responsibility, he felt it would have a detrimental effect on the welfare and financial stability of the program.

COMMISSIONER NORDSTRAND understood that Mr. Wellington was saying that once the bill was to become law he was on board to move forward in a positive way to implement SB141. MR. WELLINGTON replied in the affirmative. COMMISSIONER NORDSTRAND recalled Mr. Wellington's resignation letter to Mayor Sullivan that recognized SB141 had passed and his continued criticism of SB141 going forward. MR. WELLINGTON stated he was also an elected member of the PERS Board and Mayor Sullivan was the chairman of that board. That letter did not have anything to do per se with the ASPIB, but was in regard to the PERS Board. He reiterated that what he says and does are understandable and there is no second-guessing.

MR. PIHL asked how Mr. Wellington manages his own investments. MR. WELLINGTON replied that he uses Merrill Lynch, but he looks over their shoulder. He stated that his broker can attest to the fact that he is very inquisitive.

MR. SEMMENS asked why Mr. Wellington should be chosen for this position. MR. WELLINGTON replied that this is the first time that the ARMB has an opportunity to look at someone with experience in Alaska. He felt that should not be a significant factor in selection, but it should be a factor. He stated he has long experience with the system and with the board, and he has knowledge of money managers and other consultants working for the ARMB. He felt he could bring his wealth of experience serving on the ASPIB and on the PERS Board to the ARMB.

MR. SEMMENS thanked Mr. Wellington for his interview and for his long service.

George Wilson

MR. SEMMENS asked for a summary of Mr. Wilson's qualifications and asked why he is interested in this position.

MR. WILSON stated he grew up in Pennsylvania and moved to Boston when he was 18 to attend college. He attended school in Boston and, after graduating with a degree in accounting and finance, began his career with the international accounting firm of Price Waterhouse. He began working in the audit department and transferred to the finance department. In Boston the practice is heavily focused on financial services. In his last years with Price Waterhouse had had a heavy focus on the real estate and oil and gas industries. He moved to New York City in 1981 to join a boutique investment banking firm where he spent ten years in the direct investment business, primarily in the areas of oil and gas, real estate, and technology investing, with some exposure to the public markets. In the early 1980s oil and gas prices were spiking, there was a great deal of institutional interested in the oil and gas industry, and he put together drilling partnerships with large financial institutions. With the price crash in the 1983-1984 time frame, that rapidly changed to the workout business to restructure billions of investments predicated on higher oil prices. He noted that 20 years ago the real estate business was in fairly similar circumstances as it is today with excess capital chasing very low yielding properties, but with tremendous demand from both institutions and individuals. One of the biggest differences today from 20 years ago is that interest rates were significantly higher and there was a big building boom. During that time frame he formed his own company with 40 employees doing workouts on a contract basis for a large institutional investor. As the capital markets became more conducive to real estate, the real estate investment trust business was born and he was an active participant in restructuring much of the individual and institutional transactions that needed new capital. That capital cycle continued for 24 months until interest rates spiked. Shortly thereafter, he was seeking new opportunities and he started up a software data compression company. The opportunity came in 1998 to join the Commonwealth of Massachusetts Pension Fund PRIM. The last eight years through last summer he worked on PRIM's activities, beginning with sole responsibility for a \$800 million real estate portfolio that grew to \$3 billion. He also started and grew a \$1 billion REIT investment portfolio and a \$1 billion timber portfolio.

MR. SEMMENS asked whether anything has occurred since Mr. Wilson's last meeting with the IAC Committee that would change any of his responses to questions then. MR. WILSON replied in the negative.

MR. SEMMENS asked how Mr. Wilson stays informed on current events in the investment world. MR. WILSON replied that his primary source of information is his day-to-day activities and contacts in the investment world, combined with professional reading. He is also a frequent attendee of seminars and a speaker at seminars.

MR. SEMMENS noted that the preference for this IAC seat is gives preference to candidates with a minimum of 10 years' experience as a manager, director or trustee of a pension or public fund of \$10 billion or more in market value. He asked what Mr. Wilson's particular strengths are with regard to that preference. MR. WILSON responded that he worked 8 years for the

Commonwealth of Massachusetts Pension Fund. In particular, he was responsible for the day-to-day management of real estate, timber, and public market securities portfolios. When he originally joined the plan there were only three professional staff, so all staff assisted in administrative tasks of running the plan, which included conducting searches to hire custodians, accountants, and consultants, and many other day-to-day activities in running the pension plan.

MR. SEMMENS asked whether Mr. Wilson has ever served as a trustee. MR. WILSON replied in the negative.

MR. SEMMENS asked whether Mr. Wilson is currently a candidate for future employment or employment with other boards and commissions that would affect his availability to the ARMB's IAC. MR. WILSON replied in the negative.

MR. SEMMENS asked whether Mr. Wilson is willing to take a position that appears to be contrary to that of the ARMB, other advisors including IAC members, or staff. MR. WILSON replied in the positive. He stated the hallmark of this society is the freedom to have a healthy debate. He believes it is important for any organization to foster differences of opinion. The unique aspects of running a public plan require the right time and place for having those conversations and one must be diplomatic in expressing one's opinions.

MR. SEMMENS remarked that on July 1, 2006 newly hired employees of the PERS and TRS systems would be involved in a defined contribution plan. He asked that Mr. Wilson describe any experience he has with defined contribution plans or similar plans, such 401(k) plans. MR. WILSON stated he is a defined contribution participant and faces these issues himself. He thought that unless one is fortunate to work for a large corporation that can maintain a defined benefit plan or is a state employee that has defined benefit, one's primary source of retirement earnings will come from a defined contribution plan. While at the Commonwealth of Massachusetts there were numerous debates about switching from defined benefit to defined contribution. There is a gubernatorial race underway in Massachusetts and one of the candidates is proposing the conversion the State of Alaska has undergone. The Massachusetts defined benefit plan has been supplemented with a defined contribution plan. An extensive process was undertaken approximately six years ago to evaluate and revise that system's defined contribution plan. He was able to observe many meetings and participate in discussions relative to selection of managers. The objective is to find best in class managers who deliver above average performance at reasonable fees. He thought it was important for defined contribution participants to have a reasonable level of choice so they can assemble a sophisticated asset allocation.

MR. SEMMENS asked for discussion of Mr. Wilson's experience with alternative investments in which the ARMB is not invested. MR. WILSON replied that he was also responsible for the private equity portfolios at PRIM in 1999 and 2000. His experience has been in fairly broad asset classes, including real estate and timber. Under the direction of the board, the investment committee, chief investment officer, and executive director PRIM undertook a detailed study to determine whether or not timber was an asset class into which it desired to invest. A decision was made to enter that asset class at an opportune time. Under his direction with the assistance of many others the plan entered the timber asset class and invested \$1 billion over an 18-month period. In 1998 when he joined PRIM a similar process was undertaken with respect to REITs.

Investment was made in REITs in 1998 and, although the market was volatile, more funds were invested subsequently and REITs have been the best performing asset class at PRIM for the five years ended September 2005. He remarked that in these types of asset classes it is important to be ready to move when market opportunities present themselves. He noted that Dr. Mitchell was his boss at PRIM and he looked at a number of asset classes, such as commodities, and he was fortunate to be a part of that process.

MR. SEMMENS presumed that the growth in the real estate allocation at PRIM from \$800 million to \$3 billion was not all appreciation and that there must have been a conscious decision to expand the allocation. MR. WILSON responded that Dr. Mitchell undertook a major review of the asset allocation at PRIM that resulted in significant changes to asset allocations, the primary of which was an increase of real estate from 6% to 10%. Concurrently, he approached Dr. Mitchell three years ago when interest rates were low to discuss the opportunity to put leverage on the portfolio. The leverage was gradually brought to 50%.

MR. TRIVETTE thanked Mr. Wilson for his interest and time.

MR. SEMMENS asked that Mr. Wilson discuss why he should be chosen for this position. MR. WILSON replied that the investment world is amazing and, particularly after studying it in the large institutional arena, it has come to him how difficult it is to out perform the public market. He stated that as hard as he has tried to beat the public securities benchmark, he has come around to indexing. In the asset classes in which he works there is tremendous opportunity for beating the benchmark. In this apparently lower return world, there is an opportunity to beat the benchmark and add value in those areas; those are, however, some of the riskier areas. He felt he would bring to bear a great deal of direct experience in working with some fairly difficult asset classes. He remarked that an investment in the average private equity fund would likely deliver an S&P 500 return.

BREAK 2:43 p.m. to 2:47 p.m.

Board Discussion and Selection

MR. WILLIAMS moved to convene an Executive Session for the purpose of discussing the candidates and that the attendance of the Executive Session be limited to Trustees, legal counsel and the CIO, Mr. Bader. MR. SEMMENS seconded.

Without objection, the motion PASSED unanimously.

EXECUTIVE SESSION 2:48 p.m. to 3:33 p.m.

COMMISSIONER NORDSTRAND moved to adjourn the Executive Session. MR. TRIVETTE seconded.

Without objection, the motion PASSED unanimously.

MS. HARBO moved to nominate Tim O'Brien for continued service on the IAC. MR. TRIVETTE seconded.

MR. SEMMENS asked whether a second nomination could be made. CHAIR SCHUBERT replied that there was no motion to close nominations, so another nomination could be made.

MR. PIHL moved to nominate George Wilson to serve on the IAC. COMMISSIONER NORDSTRAND seconded.

COMMISSIONER NORDSTRAND moved to close nominations. MR. TRIVETTE seconded.

Without objection, the motion PASSED unanimously.

CHAIR SCHUBERT asked that a ballot vote be taken. MR. SEMMENS asked if the vote would be by written ballot. CHAIR SCHUBERT asked for direction from counsel. MR. JOHNSON thought if the first nomination prevails then Mr. O'Brien is elected and, if not, then the second nomination would be considered. MR. SEMMENS asked if a written ballot could be done. MR. JOHNSON believed the rules are that the public has a right to know how individual members vote.

COMMISSIONER NORDSTRAND asked that the vote be taken by roll call and persons can say the name of the candidate they prefer and the votes tallied can then be tallied. MR. WILLIAMS noted that Roberts Rules would allow either a written ballot or a roll call vote, barring any state statute or public policy issue. MR. JOHNSON thought the public policy issue is with respect to the public's right to know how the members of the ARMB vote, regardless of how the vote is taken.

MR. TRIVETTE asked if a vote could be done on one candidate at a time. MR. JOHNSON felt that any method is appropriate, so long as the vote is part of the public record.

CHAIR SCHUBERT brought Mr. O'Brien's name up for consideration and asked for a roll call vote.

By roll call, vote the nomination FAILED with Trivette, Harbo, and Schubert in favor and Williams, Nordstrand, Pihl and Semmens dissenting.

CHAIR SCHUBERT brought Mr. Wilson's name up for consideration and asked for a roll call vote.

By roll call, vote the nomination PASSED with Nordstrand, Pihl, Semmens, Trivette, Williams and Schubert in favor and Harbo dissenting.

CHAIR SCHUBERT expressed her thanks to Mr. O'Brien for his years of service with the SPIB and ARMB. MR. PIHL noted that every ARMB member expressed that sentiment. MR. O'BRIEN stated he has enjoyed the experience, he has benefited from it, and he has contributed

to the success of the organization. He stated he would look back on this as a positive experience in his career.

CHAIR SCHUBERT departed at 3:45 p.m. and VICE CHAIR TRIVETTEE conducted the meeting.

IX. UNFINISHED BUSINESS

1. Action Items

JUDY HALL reviewed the updated meeting calendar included in the packet. The Real Estate Committee meeting is scheduled for August 2, 2006 in Juneau. She indicated she also included a proposed 2007 meeting calendar. MR. PIHL noted that the Audit Committee would also meet on November 27, 2006. MS. HALL offered to contact all Trustees and staff to confirm that the 2007 calendar can be accommodated. COMMISSIONER NORDSTRAND felt it was helpful to hold meetings in Juneau during the legislative session and suggested that it would also be good to meet in Fairbanks.

2. Disclosure Report

JUDY HALL reported that a disclosure report is contained in Trustees' packets. She noted that Mr. Pihl had faxed a disclosure report that had not been included in the packet, but was timely filed.

VICE CHAIR TRIVETTEE asked which Trustees are members of the Budget Committee. MS. HALL stated that no chair is assigned to that committee. She stated she would update the ARMB on the composition of the committee. MS. TAYLOR noted that Trustees Corbus and Schubert are members of the Budget Committee.

3. Legal Report

ROB JOHNSON reported on *Duncan v. RPEA*, which was later called *RPEA v. Mataczowski*, which is a healthcare case. In June 2003 the Alaska Supreme Court concluded that health benefits are protected by anti-diminution provisions. The Court said benefits not costs are to be compared and diminution is to be measured on a group basis subject to specific caveats. The Court said that health insurance benefits must be allowed to change as health care evolves. The Court also said there has to be equivalent value proven by reliable evidence, that individual showings of hardship can be an exception to the analysis, and that there should be no major deletions of types of coverage. The Supreme Court remanded it to the Superior Court to determine whether or not there had been a diminution. A trial was held and on April 27, 2006 the Superior Court judge ruled that, based on the 1999-2000 changes to health benefits, there had been no diminution. The Superior Court concluded that this was a battle of experts. The judge found more in favor of the experts presented by the State than those presented by the challengers. The Superior Court found that the experts posed by the plaintiffs contended that there should be a higher standard of actuarial care when there is a constitutional issue at plan. The judge concluded that was that expert's opinion and not a question of law. The Court also found that any subjective belief that the various handbooks guaranteed a contractual right that the coverage and any resulting expenses would not change was unreasonable. The judge also found there was no evidence that State officials acted in any breach of any duty, including

fiduciary obligations. In the April 27, 2006 decision the judge said that the State was to submit a judgment within 10 days. Once a judgment is in place, there can be appeal rights. He checked today and presumed by virtue of negotiations between the State and the plaintiff, no judgment has been entered yet.

COMMISSIONER NORDSTRAND asked if the court reached an opinion on the prevailing party attorney fees. MR. JOHNSON replied that the court found neither party was the prevailing party and each should bear their own costs in attorney's fees. He understood that the court concluded that the plaintiffs prevailed on the constitutional issue of health insurance being protected, but did not prevail on the facts.

COMMISSIONER NORDSTRAND thought it was important for the ARMB to understand that in terms of costs, the funds paid \$500,000 in expert fees and attorney's fees to successfully defeat this case. This cost cannot be recovered. Every time the plan changes to some degree, someone can sue and that is a risk and an expensive proposition.

X. NEW BUSINESS

COMMISSIONER NORDSTRAND reported regarding the Judicial Retirement System that SB237, which passed in the Legislature, had the effect of increasing the number of Superior Court judges by six. That bill also had the effect of raising judicial pay rather dramatically. That said, the benefit paid from the Judicial Retirement System is based upon the salary of the position held upon retirement. When the pay of judges is raised 30%, the retirement benefit is raised 30%. Buck Consultants was asked to consider what this would do to the unfunded liability and the actuarially calculated rate. The Commissioner of Administration sets the rate for the system every two years. There is some dispute about some portion of the raise because SB237 may have repealed the 2% raise that other State employees are getting July 1, 2006. Buck's analysis was that as of June 30, 2004 the accrued liability of the Judicial Retirement System was \$80.1 million. The July pay raise increased the accrued liability to \$81.6 million. The new bill increased the accrued liability to \$99.4 million. There is no commensurate increase in actuarially valued assets. The funding ratio will drop from 87.9% in June 2004 to an estimated 70.8% as of the date of SB237. The actual employer contribution rose from 37.37% to 60.48%. There have already been discussions with the court system about this being an unanticipated expenditure for 2007. Going forward, this is over \$1 million in increased costs just for jurors' contributions over the next fiscal year.

MS. HARBO asked if the six new hires would be under the Defined Contribution plan. COMMISSIONER NORDSTRAND did not think that is the case because the Judicial Retirement System is a separate plan.

MR. PIHL asked what amortization period is used in the calculation Trustee Nordstrand referenced. COMMISSIONER NORDSTRAND replied that the amortization period was 25 years. He noted that there might be an adjustment if the 2% raise that other State employees are getting July 1, 2006 was removed from the judges' bill in favor of the current salary structure.

VICE CHAIR TRIVETTE thought SB141 required that the actuary do an analysis before legislation is passed. He asked if that happened in this case. COMMISSIONER NORDSTRAND

did not know if that requirement applies to this plan, however, an analysis was done beforehand. MR. PIHL asked if that was a fiscal note to the bill. COMMISSIONER NORDSTRAND was unsure, noting that the bill was swift-moving.

COMMISSIONER NORDSTRAND next informed the ARMB that on June 1, 2006 the Alaska Supreme Court issued an order in Anchorage Civil Liberties Union (ACLU) v. State of Alaska and the Municipality of Anchorage (MOA). This is the case where the ACLU sued the State and MOA for failing to provide same-sex partner benefits under its active healthcare plans, union health trust plans, and retiree plans. Last October the Supreme Court issued a decision that the State and MOA are discriminating against same-sex couples in not providing this benefit. Some years ago a constitutional amendment to the Alaska Constitution was adopted defining marriage. That being the case, same-sex partners cannot be married. The argument was made to the Supreme Court that because heterosexual people can be married, but same-sex partners cannot, there is discrimination against same-sex partners because they could not possibly get the benefit while a committed heterosexual couple could get married and get the benefit. In a fairly unusual move, the Supreme Court retained jurisdiction on the case. Last December or January briefs were filed on what remedies should be used. The Department of Law, in coordination with the Department of Administration, set out the time line in order for this to be implemented. First, there would have to be legislation, that legislation would have to pass, it would have to be signed by the Governor, a 90-day effective date would be required if it did not achieve a two-thirds vote in the Legislature, and then regulations would have to be promulgated and forms created. In January the State told the Supreme Court all of this could not be done until January 2007. The Supreme Court issued an order on the remedy on June 1, after the Legislature had concluded its regular session. However, the order requires that the appellees must provide no later than January 1, 2007 benefits complying with this court's opinion of October 20, 2005. Appellees' requests for interim benefits have been denied. This case was remanded to Superior Court for further proceedings and the Superior Court shall enter such orders as may be, in the judgment of the Superior Court, necessary to ensure the appellees' expeditious compliance with the court's opinion. Appellees must file pre-deadline statements outlining the steps they plan to take to achieve compliance and those must be filed in Superior Court within 30 days of the order. The Superior Court may also adopt interim guidelines for implementation, including early deadlines for adopting and publicizing criteria for qualifying domestic relationships, a deadline for distributing forms in which employees must apply for the benefits, and a deadline for completing the initial enrollment of employees in qualifying domestic relationships.

COMMISSIONER NORDSTRAND stated that criteria must be developed to define a committed same-sex relationship, who does and who does not qualify for the benefit, etc. He stated that the Department of Administration does not run the union health trust, so this court ruling will add cost. There are estimates of 0.5% to 2.0% increase in cost. There will need to be some type of notification process for the union health trust.

Further, because the IRS does not recognize these kinds of relationships as giving rise to a tax-free opportunity, any benefit provided to a domestic partner is a taxable event. Other jurisdictions that have done this have gone to the market to determine the cost of the coverage in the market and that cost is added as imputed income to the employee with the partner. VICE

CHAIR TRIVETTE asked if there would also add that much to the retiree's taxable income. COMMISSIONER NORDSTRAND believed there is likely some tax implication.

MS. HARBO asked if the process for open enrollment must be redone. COMMISSIONER NORDSTRAND explained the process would be an application signed by both partners attesting to criteria set out in statute or regulation. That application must be submitted to the Division, evaluated to see if meets the criteria, and there will be approval or disapproval. An appeal process is available if the application is disapproved. There will be an open enrollment process.

XI. OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None

XII. PUBLIC/MEMBER COMMENTS – None

XIII. INVESTMENT ADVISORY COUNCIL COMMENTS

DR. MITCHELL remarked that he felt the roundtable panel was a great success. He suggested that this format be continued for managers of other asset classes. It was also good to consider new and unusual investments, RCM and Sparx, even if many are not ultimately used. He stated it has been a pleasure to work with Mr. O'Brien and he has learned from him.

MR. O'BRIEN wished the ARMB Godspeed and success in the markets.

DR. JENNINGS stated he also likes the panel approach because it allows the ARMB to think about a particular asset class and how it is implemented. He noted that the ASPIB conducted economic panels and that might be another way to help frame the ARMB's investment process. He encouraged that this process be continued.

XIV. TRUSTEE COMMENTS

MS. HARBO thanked Judy Hall and the DOR for organizing an excellent education conference. She thanked Mr. O'Brien for his years of service to the ASPIB and the ARMB.

MR. WILLIAMS thanked Mr. O'Brien for his service, noting that he appreciated Mr. O'Brien's comments at the ARMB meetings.

MR. PIHL thanked Mr. O'Brien for his service. MR. PIHL re-emphasized his concern about the contribution levels and the snowballing of the unfunded liability and the fact it is not being addressed through increasing the cash flow into the plans. He expected this issue would be dealt with at the September 2006 meeting when rates are set.

MR. TRIVETTE thanked Mr. O'Brien for his contribution to the ASPIB and ARMB.

MR. SEMMENS also thanked Mr. O'Brien for his contribution. He noted that the ARMB would not have a special meeting to review the actuarial results. Normally he thought it would be important for the ARMB to formally accept such reports. He was personally concerned that members of his community want this information. He did not know if there is a downside to the ARMB receiving a draft and giving comments to staff and then letting it be public. In general, he

wanted the ARMB to accept the information formally. He stated that at this point he would like to get the information out, at least in draft form.

VICE CHAIR TRIVETTE was uncomfortable waiting until October 2006 to get the actuarial report. He was concerned that since it is now clear that the ARMB has a responsibility to either accept or possibly modify the actuarial assumptions, he was not sure there would be sufficient time to do that in addition to the regular business at the October 2006 meeting. MR. BADER did not understand why the ARMB is not considering setting a time before October 2006 to receive the report. The statute says "the results of actuarial assumptions prepared under this paragraph shall be reviewed and certified by a second member of the Academy before presentation to the board." Therefore, he did not think the ARMB could get the report in draft, but the ARMB would get it with certification. He believed a special meeting could be scheduled.

MR. SEMMENS noted that Chair Schubert understood an additional meeting was not needed. He stated he would like to get the certified report as soon as it is available and that it be published as a draft. MR. BADER thought that the ARMB could get its meeting packet a month early in order for the Board to get the information in September. That will not give an opportunity to see what would be the computation if there were a 30-year amortization rate or what the rate would look like if the ARMB is off the projected unit cost. He believed Ms. Millhorn favored not using projected unit cost. MS. MILLHORN felt there is merit to that, but

that the ARMB will have to look at the information from the actuary and then decide. MR. BADER feared the ARMB could lose its opportunity to give direction. MR. SEMMENS stated he would like the information to be out soon and, if that entails a special meeting, he would favor that. He felt the information could be made available with the caveat that this is the actuarial report and it does not bind the ARMB to the rates shown in it. He thought he has asked for 30-year amortization information. The danger in putting out a draft is that the numbers may be different from what is ultimately adopted, particularly as to the past service costs of each individual employer.

VICE CHAIR TRIVETTE asked if there is a problem with making the actuarial information available although the ARMB has not reviewed it. MR. BADER was unsure of the answer to this question from a legal standpoint, but he felt it was not good practice to put out a document that is not formally adopted by the ARMB.

MS. HARBO noted that the Real Estate Committee is meeting August 2, 2006 and perhaps there could be a special meeting of the ARMB at that time. VICE CHAIR TRIVETTE suggested that the Trustees share comments with Mr. Bader regarding a special meeting. MR. PIHL asked if the draft actuarial report is a work product that is not subject to being made available as a public document. COMMISSIONER NORDSTRAND replied in the negative. MS. HARBO felt the full ARMB should be presented with the document and in sufficient time to review it and discuss it.

COMMISSIONER NORDSTRAND commented that corrections may be made internally to ensure the data is correct and he felt the information should not be out publicly in different versions. He asked that a timeline be developed to get the information out as expeditiously as

possible. He was cautious about giving out documents that have not been corrected and have people rely upon them.

MR. TRIVETTE confirmed that the Real Estate Committee meeting is located in Juneau.

XV. FUTURE AGENDA ITEMS – None


XVI. ADJOURNMENT

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

There being no objection, the motion PASSED unanimously.

THERE BEING NO FURTHER BUSINESS TO COME BEFORE THE BOARD, THE ARMB MEETING ADJOURNED AT 4:30 PM ON June 15, 2006.


Chairman of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

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 Board offices.

WORDSMITH
Kimberly D. Stalder
Anchorage, Alaska