ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

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

MINUTES OF
February 8-9, 2007

Thursday, February 8, 2007

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
Sam Trivette
Gayle Harbo
Gail Schubert
Larry Semmens
Patrick Galvin
Mike Williams
Annette Kreitzer

ARM Board Members Absent
Martin Pihl

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

Department of Revenue Staff
Brian Andrews, Deputy Commissioner, Department of Revenue
Gary Bader, Chief Investment Officer
Bob Mitchell, State Investment Officer
Bree Simpson, Assistant State Investment Officer
Susan Taylor, Comptroller, Treasury Division, Department of Revenue
Judy Hall, ARMB Liaison Officer, Department of Revenue

Department of Administration Staff
Annette Kreitzer, Commissioner, Department of Administration
Melanie Millhorn, Deputy Commissioner, Department of Administration
Charlene Morrison, Chief Financial Officer, Division of Retirement and Benefits, Department of Administration

Department of Law
Mike Barnhill, Department of Law

IAC Members
Jerrold Mitchell
George Wilson

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.

COMMISSIONER KREITZER asked to add two additional resolutions to the agenda. MS. MILLHORN explained that Resolution 2007-04 relates to PERS Cost Share and Resolution 2007-05 is a TRS appropriation resolution. CHAIR SCHUBERT suggested that these items be added under agenda item 21 to be considered with the other resolutions. MS. HARBO asked if the resolutions are available for review. MR. JOHNSON indicated he has the first draft, but additional revisions were made last evening and copies of the final will be brought to the meeting shortly. COMMISSIONER GALVIN asked whether 20 minutes would be an adequate time frame to consider all of the resolutions or should these additional resolutions be considered with the subject matter on the agenda, that is, item 19 for Resolution 2007-04 and item 22 for Resolution 2007-05.

COMMISSIONER GALVIN noted that the agenda does not include a report on proposed legislation that might be of interest to the Board. He asked that this could be provided somewhere in Reports. MS. HARBO indicated that part of the CIO Report includes discussion of legislation, but one item is not listed. COMMISSIONER KREITZER felt it was important to set aside a specific agenda item regarding legislation to allow the ARMB to be more involved in that regard. CHAIR SCHUBERT suggested that legislation be dealt with under New Business, item IX.

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 November 28-29, 2006. MR. SEMMENS seconded.

MR. TRIVETTE corrected page 21, the last paragraph, to change the phrase "with introduction of the new DB" to "with introduction of the DC." He explained that DC was the acronym used for Deferred Compensation for years, so he wished to change the reference to be clear and instead refer to Defined Contribution as DCP or Defined Contribution Plan. COMMISSIONER KREITZER thought the Legislature has been addressing the Defined Contribution Plan as DC and there is a risk that they would not understand the reference to DCP. She suggested that the reference to Deferred Compensation be changed, if necessary. MR. TRIVETTE suggested spelling out Deferred Compensation. This was agreeable to all parties.

There being no objection, the motion passed unanimously.

VII. REPORTS

1. Chair Report

CHAIR SCHUBERT reported that she and Mr. Bader provided input to the Department of Revenue Transition Team and made a presentation to the Executive Board of Commonwealth North on retirement system funding issues. She indicated that this afternoon she has to offer testimony before the Senate Judiciary and would need to excuse herself briefly to do so.

2. Committee Reports – None

3. CIO Report

GARY BADER asked that MacKay Shields be removed from the Watch List. They were placed on the Watch List approximately one year ago because of changes on the investment team. The benchmark was changed during that time period, so examining their performance against the benchmark over a one-year period is not helpful. Compared to ING Clarion, there has been no decline in the implementation of MacKay Shields' high yield strategy.

MS. HARBO moved to remove MacKay Shields from the Watch List. MR. SEMMENS seconded.

There being no objection, the motion passed unanimously.

MR. BADER stated Resolution 2006-20 was tabled at the ARMB's last meeting and a suggestion was made to change language in order to more clearly reflect that there is annual crediting to PERS and TRS members' accounts. It was brought to the Board's attention that the Division of Retirement and Benefits (DR&B) had concerns with the new language. After discussions, it was suggested to remove this item from the agenda, as it is not necessary.

MR. WILLIAMS moved to dispose of Resolution 2006-20. MS. HARBO seconded.

There being no objection, the motion passed unanimously.

MR. BADER stated the ARMB has authorized Staff and Callan Associates Inc. (CAI) to engage in searches for a long/short equity manager and a large cap value manager. That work is nearly complete and a presentation is scheduled for the April Board meeting. In reviewing the long/short equity manager strategy, Mr. Bader's staff reviewed attributes of those managers and, while there is some history, did not feel that the projected alpha was sufficiently strong when considering the tracking error and fees for the program. Staff is prepared to proceed with the search, but asked that the Board terminate the search.

MICHAEL O'LEARY with CAI stated a tremendous amount of work was done on this project and there were many meetings and discussions with staff. This is such a new area that performance histories for the specific products being proposed are generally limited. Embedded in the approach, investors are investing 60% more in assets than traditional managers and their fee schedules reflect that greater responsibility. It was surprising how modest the incremental return expectations were relative to that fee. He believed this area would become more important, but did not see urgency in the ARMB becoming a first mover.

MR. TRIVETTE moved to direct staff to terminate the search for the long/short equity manager. MR. SEMMENS seconded.

There being no objection, the motion passed unanimously.

MR. BADER next reviewed a memorandum to State Investment Officer Steve Sikes to liquidate $25 million of REIT holdings; this is within the CIO's authority, but he felt that it was appropriate to inform the Board. This fiscal year return has been an over 30% in this internally managed investment program. This program follows an algorithm that staff developed, and the portfolio is rebalanced monthly. Investments are made with the substantial dividend income. There is never market timing with this program. Over the past several years, the fixed income portfolio has been used to provide liquidity to the pension funds. The fixed income allocation is near the bottom band, so Mr. Bader has to begin liquidating other asset classes to meet pension payments. In anticipation of a larger appropriation by the Governor into the PERS and TRS systems, a decision was made to build up some of the private equity investments. MR. BADER stated he will need to liquidate some equity investments in order to meet pension payments over the next several months and would be accessing the REIT and similar accounts to do so.

MR. TRIVETTE concurred with Mr. Bader's approach. He asked what the balance in the REIT account is. MR. BADER replied that it is roughly $125 million and noted that the balance increased 10% last month.

MR. BADER next reported on an announcement by UBS Global Asset Management that they have changed the head of their global real estate program. Jim O'Keefe who has been in that position will take on other assignments in anticipation of retirement. Ordinarily a fund would be put on the Watch List for a staff change, but this position is far up, so that is not recommended.

MR. BADER reported that copies of the required reports to the Legislature have been provided to the Board. Those reports have been transmitted to the Legislature.

MR. BADER reviewed an item related to a request by Mr. Semmens asking CAI about the accuracy of its 5-year capital market assumptions. CAI has supplied a good deal of information and is available for the ARMB's review. MR. O'LEARY remarked that each year CAI undertakes an exercise of looking back five years and determining if the actual results have been in the ranges CAI anticipated and almost without exception that has been the case. CAI is very pleased with this result.

MR. BADER next reviewed Resolution 2007-01, Relating to the Disclosure of Alternative Investment Records. When it was constituted the ARMB adopted the previous board's resolutions and investment policies. Over a period of time, each resolution is being brought back to the ARMB for review and approval. The first relates to the disclosure of alternative investment records. Periodically, staff has received requests for information on private market investments, primarily from vendors who are gathering this information for resale. The Board has adopted regulations in the past to protect disclosure of this information if it could negatively affect the Board's competitive advantage in the markets. MR. BADER noted that the regulation referenced in the resolution should be 2AAC96 rather than 6AAC96. This resolution is designed to protect the Board from being required to disclose sensitive information under the Freedom of Information Act (FOIA).

MR. TRIVETTE <u>moved to adopt Resolution 2007-01</u>. MS. HARBO <u>seconded</u>.

MR. JOHNSON explained that the FOIA generally says that everything handled by the public is disclosable to the public. There are exceptions, including a provision that materials are to be disclosed to the public unless otherwise provided by law. The clause "otherwise provided by law" includes statutory authority for this Board to exempt disclosure of certain privileged information. The Board has adopted a regulation that effectively provides that by resolution or by contract the ARMB can declare certain things to be non-disclosable. In many of its contracts the ARMB has provisions relating to confidentiality. With SB 141 there was additional language exempting disclosures relative to FOIA. This resolution tries to establish a workable set of exclusions and a matrix for analysis for what is and is not disclosable. This framework has been workable.

COMMISSIONER KREITZER asked if there is anything significantly different in this resolution than in Resolution 2004-11. MR. BADER replied that the language is identical, except for the regulation citation.

There being no objection, the motion passed unanimously.

MR. BADER next reviewed Resolution 2007-03 Relating to Contract Execution. If the ARMB is hiring another manager, it requires formal action at which point staff is delegated the details of negotiating contract fees, etc. If staff feels fees are excessive, the matter would be brought back to the Board. The contract is subsequently signed by the CIO, the Chair of the ARMB, and the Commissioner of Revenue. There are no changes to this policy from past practices.

MS. HARBO moved to adopt Resolution 2007-03. MR. TRIVETTE seconded.

MR. TRIVETTE asked if this process has worked without problems over the years. MR. BADER replied in the affirmative.

By roll call vote, the motion passed unanimously.

MR. BADER next explained that Callan Associates Inc. (CAI) was hired under an RFP and was approved by the previous board for hire. Their contract is up for renewal. The State has had a 15-year relationship with CAI and Mr. O'Leary. Mr. O'Leary is highly regarded by everyone in the investment industry, and was nominated as Consultant of the Year by *Institutional Investor* two years ago. There is an email in the report regarding litigation in which CAI is involved. They have settled the lawsuit with San Diego. There was an issue with the SEC related to a soft dollar brokerage arrangement. MR. BADER stated that in the time he has been involved with CAI, it has never suggested that CAI be used for soft dollar or commission rebates or anything of that nature. The staff is asking that the Board pass a resolution authorizing staff to renew the contract with CAI.

MR. SEMMMENS moved to direct Staff to exercise the first of the two one-year contract extensions for Callan Associates Inc. MS. HARBO seconded.

COMMISSIONER KREITZER asked what the cost of the contract is. MR. BADER recalled that there is a retainer of $225,000 annually and there are other provisions for special projects and manager searches; he did not believe CAI has ever charged a special project fee, although they have done many special projects. MS. TAYLOR stated the investment manager search fees are $25,000 per search.

By roll call vote, the motion passed unanimously.

MR. BADER next reviewed information regarding investment of funds in the Retiree Health Insurance Fund, which are transferred from the retirement systems to the Department of Revenue (DOR) to invest and pay health care premiums. This fund has grown substantially over the years. In past years, Commissioner of Administration Nordstrand transferred $50 million from this fund into the retirement funds because he felt those funds were not being invested aggressively enough. MR. BADER clarified that the State Financials show a combination of long-term care investments and Retiree Health Insurance Fund. Former Commissioner of Revenue Corbus reviewed the asset allocation after Mr. Bader and Ms. Morrison had reviewed it and found it to be reasonable. It has again been reviewed again and staff believes the funds available for investment have an appropriate asset allocation. No changes are recommended at this time.

MS. HARBO asked if the Retiree Health Insurance Fund includes DVA to which the retirees contribute individually. MR. BADER replied that it does include dental/visual/audio payments in the amount of $10 million, as he recalled. MS. HARBO indicated the amount is $12 million. MR. SEMMENS asked what would happen in the event any principal was lost and from where would the funds come that would replace the principal lost. MR. BADER stated there is nearly 20 times the monthly payment of retiree health care in this fund. While some loss could be suffered, this is a conservative asset allocation consisting substantially of fixed income. MR. SEMMENS explained that this fund is being conservatively invested, which is understandable because of the need to meet liquidity needs, but if it were invested more aggressively, consistent with the broader funds, presumably the returns would be higher and in the event of a loss, funds would be drawn from the other investment funds. He was pleased that this item has received attention. He encouraged everyone who has the ability to influence these numbers to keep this fund at its lowest level. MS. HARBO recalled the amount needed in that fund is 15% to 25% of the anticipated claims and in 2004 that amount was $74 million. MR. BADER stated that in a perfect world this fund would be at zero at the end of each month. Assets under management are growing because of investment returns and because the retirement plans and health plans are being monitored more carefully than in the past. He believed that recent activity is considered when the premium is set each year. MS. MILLHORN stated the DR&B looks at trends, claims experience, and the reserve amount when establishing a premium.

MR. BADER lastly reviewed the comparison of SBS returns and Defined Benefit Plan returns over the year. A weighted average of all SBS investments is calculated using a 5-year history, which yields a 7.03% rate that the average participant earned over that period of time. Some of the best performing funds are the Target 2020 and Target 2025, which are designed for participants with a long-term investment horizon. If more concentrated bets were made, higher returns were earned.

4. Financial Report

SUSAN TAYLOR stated staff has been working to address the management letter concerns about alternative investments. To that end, the assistant state comptroller and portfolio staff will travel this month and next month to meet with private equity manager Pathway Capital Management, Crestline Investors, Abbott Capital, Mariner Investment Group, Cadogan, UBS, Cornerstone, Tishman Spier, JP Morgan, and Lehman Brothers. Staff is also looking at rolling forward all activity from the beginning of the fiscal year. Deputy Commissioner Brian Andrews has been to training at the Wharton School of Business and is working with the assistant state comptroller to develop an audit plan. This will be shared with the Audit Committee in April. MS. TAYLOR stated that management has a goal to implement internal controls over alternative investments to demonstrate that fiduciary obligations are met. Due diligence trips, along with increased scrutiny over accounting, will meet those objectives.

MS. TAYLOR reported that in December there was an AOL Time Warner class action settlement resulting from the work of Mike Barnhill that resulted in $18 million to the pension funds and a small amount to the SBS funds. State Street Bank, the State’s custodian, announced they would enhance its position as a worldwide provider of by acquiring Investors Financial Services Corporation in a stock transaction valued at approximately $4.5 billion. This should have minimal impact on the State other than making the custodian better.

MS. TAYLOR briefly reviewed the Fund Financial Report. She first reviewed the summary report of the funds over which the ARMB is fiduciary. The total assets of the funds are approximately $17.7 billion. The income statement for the month follows the summary report. MS. TAYLOR then reviewed an analysis of the PERS Retirement Trust Fund in terms of total invested assets, asset allocation, investment income, and invested assets. PERS and TRS have the same asset allocation. The CIO is authorized to move within bands around each asset allocation.

MS. HARBO returned to page 2 of the report, “Schedule of Investment Income and Changes in Invested Assets by Fund” to discuss the Defined Contribution Retirement-Retiree Medical Plan and Defined Contribution Retirement-Health Reimbursement Arrangement. She asked if the amount put into the Medical Plan is 1.75% of payroll as established in SB 141. MS. TAYLOR deferred that question to Ms. Millhorn. MS. HARBO also asked if the Health Reimbursement Account rate is 3.75% of payroll. MS. MILLHORN responded that the rate of 1.75% was in statute and the actual rate is .99%. The Health Reimbursement Arrangement, which is employer only contribution, is at 3%.

MS. TAYLOR next reviewed the Schedule of Investment Income and Change in Invested Assets by manager. She explained that investments occur through a pooling structure. The manager pays one dollar amount and the custodian tracks the individual pension participation amount. She noted that this schedule is helpful during manager presentations to understand the relative value of assets under management for each asset class.

MS. TAYLOR reviewed the Schedule of Investment Income and Change in Invested Assets for PERS, TRS, JUDICIAL and MILITARY by manager. She explained that Investments in Real Estate, Real Estate Properties includes a number of underlying investment managers and real property investments. When the ARMB began investing in real estate, separate accounts were not set up through the custodian. As a result, when a working trial balance is pulled to get a balance for real estate, it includes all activity for real estate. At the next ARMB meeting, the Fund Financial will show individual accounts with individual activity. At the beginning of the next fiscal year, the investments will be split out.

MS. TAYLOR reported that the SBS has total invested assets of nearly $2.2 billion. This report shows monthly activity. Deferred Compensation has $520 million in invested assets. This report also shows monthly activity. The Defined Contribution for PERS is nearly $2.2 million. The balance for TRS is nearly $1.4 million.

MS. TAYLOR indicated that next week she would travel to State Street Bank for the annual due diligence trip. She indicated that if any ARMB members have issues or concerns, she would be pleased to relay them.

MS. MILLHORN referred to the Schedule of Investment Income and Changes in Invested Assets for the SBS and noted that the investment return for the Alaska Balanced Fund is comparable to the investment return for Brandeis International Equity Fund. MR. BADER remarked that the Alaska Balanced Fund has the same earnings as the Brandeis International

Equity Fund, but has more assets under management; this was a particularly robust period for international investing.

5. Relational Investors

For more information on this presentation, please refer to the document entitled "Relational Investors LLC, Presentation to the Alaska Retirement Management Board," dated February 8, 2007 and kept on file at the ARMB offices.

JAMES HEARTY and SANDI CHRISTIAN presented to the Board after introduction by Mr. Bader. Relational Investors received a $400 million commitment. They use a corporate governance model in the selection of stocks. A handful of stocks are represented in the portfolio. For a period of time last year Mr. Bader frequently sent emails to the ARMB related to Sovereign Bank, which was an example of how Relational applies their strategy.

MR. HEARTY explained that this firm manages money through a very concentrated portfolio of generally 10 stocks. The portfolio is further concentrated within that number of stocks so it is common to have 80% to 85% in just four names. The firm generally tries to buy large positions in companies that have been poorly managed or that have performed poorly. Over time the results are good, but they are very volatile. Little has changed in terms of the organizational management since the ARMB hired Relational. The firm's methods have not changed and its investment policy has not changed.

MR. HEARTY reviewed performance since inception and for 2006, as well as fiscal year performance. For the fiscal year the portfolio outperformed the S&P 500 by 741 basis points. The attribution chart for 2006 illustrates that one position performed very poorly, Computer Associates; when a mistake is made, it hits performance hard. The large under performance periods have occurred when one of the investments has underperformed significantly. Fiscal year-to-date some of the stocks have been predictably strong. Inception-to-date attribution reveals that the largest problem was participation in Computer Associates.

MR. HEARTY reviewed the portfolio holding in Prudential Insurance. This position has been held for five years, having purchased the stock when the company went public. The company had been under managed. It has performed very well since purchase. The ARMB bought it at $65 and it is at $92 today. Relational has worked very cooperatively with management and management has done a very good job. The return on equity (ROE) was 6% when the company went public and ROE should be 18% next year. The projected price is $100, so Relational is close to selling it. Baxter Pharmaceutical was very poorly managed. This stock was purchased when there was a change in management. The new chair had significant experience in this business. It took two years for the company to turn around. In July of 2006 it went from $36 to $45 per share in a four-week period. They are having a shareholder investment day next month and Relational expects them to be very positive about their prospects.

The third largest holding in the ARMB portfolio is Home Depot. Relational bought this stock in November/December and the Home Depot shareholder resolution rules required that a shareholder resolution be filed by December 15. Relational filed one on December 15, a Friday, and suggested to the chair of the board that a meeting be held in January to discuss their concerns. It was a fairly aggressive proposal. The following Monday, the chair of Home Depot made Relational's proposal public and stated an intent to fight. He left two weeks later. Relational has been in negotiations with the board in the last month and settled this week. One of Relational's partners will join the Home Depot board on February 22nd. Relational has agreed to stay on the board for three years. Home Depot agreed to a policy of turning over their board membership. Relational has given them extensive presentations on where their strategy has gone awry. They need to work hard in their stores. Their expansion strategy to buy providers failed. Relational will continue to work with them. Meetings with their board have been constructive and cooperative.

Relational threatened to run a proxy contest with Sovereign. Lawsuits were filed. A proxy contest was not run; Relational was offered a seat on the board, which it took in April. In October the longstanding chair and CEO was dismissed. This is a well established, regional bank in the northeastern US with a good footprint for a franchise. They had been acquiring many other banks, but each acquisition diluted the current shareholder. It was also very poor run. Relational felt they needed to stop acquiring and run the bank better. Relational rarely sees sale of a company as an exist strategy, but this company may be sold. A significant share of stock had been sold to a Spanish bank and they are very interested in buying a franchise.

MR. HEARTY explained that the portfolio is structured such that a large investment is made and then allowed to run without cutting back for a period of time. The portfolio owns 4.9% of UnumProvident stock. Going over 5% means that more specific reports about the transactions in the stock must be filed. People watch what Relational is doing in buying and selling stocks, so Relational tries to stay below 5%. This will not be possible with UnumProvident.

MR. BADER asked for an explanation of thresholds in terms of ownership and how Relational keeps people from front running. MR. HEARTY replied that Relational is a registered investment advisor so 45 days after the end of each quarter, its holdings are filed with the SEC. Stock in WAVE has begun to be acquired, but the holding has not had to be made public yet. A holding must be disclosed in one of three ways: filed in quarterly reports 45 days after the end of the quarter, immediate filing if over 5% is owned, and same day filing of sales and buys that are over 10%, making the holding subject to restrictive short-term swing profits. Relational watches this closely because when it buys or sells there is likely to be activity by others in the market.

MR. O'LEARY asked for a description of how the ARMB has invested with Relational, the vehicle used, the life of the vehicle, etc. MR. HEARTY stated the ARMB has a separate account in the form of a limited partnership. There is no term to the life of the account. MR. O'LEARY emphasized that for a traditional long-only stock manager a separate account is customarily at State Street and there is transparency to the individual issues and with Relational there is an intermediary.

MR. HEARTY lastly reviewed statistics that show that portfolio performance over time is volatile and while there is substantial over performance compared to the benchmark, half of the time there is under performance. There is some stock selection and some sector selection. Relational does not buy things that are leveraged or things that are dependent on commodity risk. In periods of time when the energy markets do well, for instance, Relational will under perform. Nearly half of the ARMB's under performance last year was due to not owning oil stocks. Over a 10-year period of time this does not hurt the account. MR. HEARTY stated the firm feels confident in its strategy and positively about its large positions. He noted that Relational is involved in shaping the strategies for the companies in which it has big investments.

COMMISSIONER GALVIN asked what decisions are made that result in investing in these companies. MR. HEARTY explained there is a sell price on every stock, which is a present value calculation of what Relational thinks it should be worth. Some stocks are sold if the holding approaches 10%. In the case of Computer Associates, Relational changed its opinion because of loss of confidence in management and the board, among other things. There needs to be sufficient reward for the effort Relational has to put into a holding.

BREAK 10:25 a.m. to 10:35 a.m.

6. Tukman Capital Management

MEL TUKMAN and DONNA WILLS COLSON presented to the Board after introduction by Mr. Bader. This manager runs a concentrated mandate on behalf of the ARMB. MS. COLSON explained this investment firm is located in the San Francisco Bay area in Larkspur CA. It is single strategy firm. All client assets are managed in the same manner as the ARMB's. The firm specializes in very large cap, high quality US stocks. Tukman is an equity manager for pension and profit sharing plans, as well as foundations and endowments, performs mutual fund sub-advisory work, and invests on behalf of wealthy individuals. Nearly 75% of the firm's work is institutionally oriented. Assets under management at year-end 2006 were $5.8 billion; the account minimum is $20 million. The firm has 62 clients with a goal of adding 3 to 4 net new clients per year over time. Investment staff has not changed since ARMB retained Tukman nearly seven years ago. MS. COLSON reviewed the backgrounds and credentials of the Tukman team.

MS. COLSON explained that the firm's investment approach begins with computer screening of the 1,500 largest stocks, which is narrowed to a pool of approximately 100 companies based on high return on equity of 15% or more, high discretionary cash flow after dividends and capital expenditures, and use of free cash flow to either buy back stock or make smart acquisitions. The holdings have a high quality rating of average A or above. The portfolio also has a moderate beta of less than one that is used to manage risk. The portfolio has high liquidity. The weighted market cap of the holdings in the portfolio is $150 billion compared to the S&P 500 at $100 billion. Stocks are purchased when they are available at a favorable P/E ratio. The firm will sell when there is deterioration in fundamentals.

MS. COLSON reviewed the objectives and goals for the ARMB portfolio. She stated the firm seeks to control growth and is selective about the type and number of clients. The firm aims to provide superior relative performance on a relative and risk-adjusted basis. It builds solid, long-term relationships.

MS. COLSON reviewed the performance of the ARMB portfolio. It carried a market value of $335 million at the end of year and had an under 2% cash position. Year-to-date for the 12 months of 2006, the portfolio was up 15.3% compared to the S&P 500 at 15.8%. The annualized since inception return is 5.02% compared to S&P 500 at 1.25%. The ARMB hired Tukman when its stocks were out of favor, so it captured a performance premium during the first two years when the stocks were in favor. The market has recently been through a period when Tukman's stocks were not as much in favor. In August the market has been coming back to Tukman.

During the seven years of ARMB portfolio ownership, small cap has out performed in each year, so Tukman has been trying to exceed the benchmark when its style is out of favor. Because of the ARMB's good timing on the front end, the performance since inception is 3% above the S&P 500 per annum.

MR. TUKMAN began with a discussion of results. The firm has had a slump during the recent 3- and 5-year periods. There are three broad reasons for this. The first is that some manager mistakes or miscues were made in this period. FNMA and Pfizer are two examples. Those represent less than one point or so of the five-point shortfall for three years. The second and biggest reason is oil being up 33% and Tukman not owning oil stocks. This cost three points of the shortfall. The third reason is the dominance of small and mid-cap stocks during the 3-year period. For the three years, the mid-cap portion of the S&P was up 16% to 18%, six points ahead of the full index. He estimated that impact represents roughly the remaining two points of the firm's shortfall. The firm lost to oil and small speculative stocks. Much has been written about the speculation boom involving hedge fund speculation, emerging markets rallying, and private equity pools. He did not know what it is, but he hoped it would not last forever. With much experience behind him, he guessed this environment would not last forever. To date, the firm is a few points ahead of the market.

MR. TUKMAN indicated that the portfolio is comprised of a short list of good companies. Lately the large stocks have come to life after being poor performers. A second bright spot are some stars in 2006. Goldman Sachs and Disney were up 60% and 40%, respectively. Tukman's stocks are desirable and are cheap by any measure. The P/E ratio of the portfolio is 16% versus 17% for the market, which is the lowest he has seen in 10 years. The Price to Value compared to speculative stocks is the lowest he has seen in 35 years. Tukman's stocks, relative to their own history, are selling at the lowest P/E in history. This is a solid portfolio of good companies.

MR. TUKMAN thanked the ARMB for retaining Tukman.

MR. SEMMENS asked for comment on the economy, where Mr. Tukman sees it going, and what type of economy bodes well for the Tukman portfolio. MR. TUKMAN responded that his firm is not good at analysis or prediction of where the economy is going, but the firm does better when there are higher interest rates, lower liquidity, and/or some external shocks. A choppier and somewhat more difficult environment could lead to a flight to quality.

MR. TRIVETTE asked, if Tukman were going to invest in oil or small cap, what would be the P/Es for those stocks. MR. TUKMAN stated oil is still reasonable so they are roughly in line with the market. Small caps range from 15-40; they are expensive.

MS. HARBO noted the firm is on the Watch List. She asked if they anticipate changing any of their holdings and, if so, what would be done. MR. TUKMAN replied that he likes the portfolio and would let it play out. The only thing done to get off the Watch List is to hope for the best.

DR. MITCHELL commented that academics would argue that mega cap stocks are more efficiently priced because there is more research. He asked that Mr. Tukman discuss the firm's research. MR. TUKMAN agreed that over the long-term mega cap stocks are more efficiently priced than other segments of the market, but they also go in waves. The firm can add experience but adds nothing technical on the research side. This is a time when these stocks are inefficiently priced.

COMMISSIONER GALVIN asked for comment on assets under management and any clients that have left the firm. MR. TUKMAN stated that in December Tukman lost an account relationship with Vanguard after 15 years. He presumed they left because Tukman lagged for three or four years. MR. O'LEARY noted that the financial impact of losing that client was not as large as one might think because the revenue generated per dollar managed is lower. MR. TUKMAN indicated that the assets represented 40% of Tukman's assets managed, but 10% of the firm's fees. It had virtually no impact on the solidity of the firm. He stated Tukman is leaner and meaner at $6 billion than it was at $10 billion of business. MR. O'LEARY remarked that profit growth over 3 and 5 years has been phenomenal, particularly in commodity areas. Profit growth is predicted to reduce to single digit levels, at which point the stable growers in the Tukman portfolio will have attractive gains. MR. TUKMAN agreed that the 10% growers would look good when compared with companies with high multiples growing at 8%. The firm lost dramatically to material companies and oil companies. If oil prices stabilize, that will work to the firm's benefit. The market has come through a surge in small stocks and a surge in oil and related materials and Tukman has never been invested in either. He stated that during a normal market, he would put the stocks and this portfolio against anything.

MS. HARBO asked if Tukman managed Windsor II for Vanguard. MR. TUKMAN replied that it managed a portion of that fund. That relationship started with $250 million in 1991 and that grew to $4 billion in 2006, even though he stopped taking cash flow twice. It was not a good business strategy on his part to let it grow that much. MR. O'LEARY understood the other sub-advisor to Vanguard was also terminated. MR. TUKMAN stated this is the case and noted that there was also a relatively new board.

7. RCM Capital Management

For more information on this presentation, please refer to the document entitled "Alaska Retirement Management Board," dated February 8, 2007 and kept on file at the ARMB offices.

PETER ANDERSON, MELODY McDONALD, and RAY EDELMAN presented to the Board after introduction by Mr. Bader. MS. McDONALD voiced appreciation for the opportunity to present to the Board and the longstanding relationship that began in 1993. She noted that the Board was given two books, one a summary and the other containing more extensive information. She introduced Peter Anderson and Ray Edelman.

MR. ANDERSON stated RCM is different because it has 19 experienced analysts with an average age of early 40s and an average experience level of 13 years. RCM has a unique resource represented by the analysts in San Francisco. There are an additional 30 analysts in Hong Kong, Singapore, London, Frankfurt and elsewhere. The companies in the portfolio are global for the most part, so the global information stream is unique. There is a cohesive group of skilled and experienced portfolio managers. The firm has a dual research platform. Grassroots is an organization of 300 reporters around the globe that do research projects for RCM that conducts basic research of companies. RCM also has a state-of-the-art communication system called RIM that links every office of RCM so that reports are electronically communicated around the globe. This system gives the firm the capacity to model and gather data that exceeds the abilities of most other organizations.

MR. ANDERSON stated he has been in the business 40 years and every organization with which he has been affiliated has worked as a team. While he believes in teams, he thinks they need to be small in order to be quick and agile. In an effort to reach agreement, large teams take too long to reach a decision. There are three person teams in RCM. The firm's research efforts are focused on drivers, which are the two to four things that will move a stock. There is a difference between a good company and a good stock. The firm finds out what will move a stock, finds out what the rest of the world thinks, and then monitors the drivers. It is not necessary to analyze everything that happens in a company, only what it takes for them to succeed.

The firm has a system of communication between managers and analysts, which are two distinct career paths. There is a buddy system where two portfolio managers are linked to every research team and the portfolio managers bring the message of the team to the analysts and to bring the message of the analysts' back to the team. The research efforts are tightly focused. For example, a growth manager must succeed in the technology and the healthcare arenas. In San Francisco there are nine portfolio managers and analysts dedicated to the technology area and another six around the rest of the globe. The same is done in the healthcare area.

The firm's compensation system is aligned with the clients' interests. Portfolio managers make good money if the portfolios succeed for the clients. This system is designed to reward excellence, to reward good returns to the client, and will not reward incompetence. It is also highly competitive. There has been nearly zero turnover in staff in the last 12 months.

Performance for the State of Alaska in 2006 was mixed. RCM failed to beat its benchmark significantly. At the same time, RCM out performed about three-quarters of its competitors.

MR. ANDERSON stated he is a perpetual optimist and also knows that there will be a time when growth out performs value. He believes in reversion to the mean and currently the gap between value and growth is large, unlike anything he has seen in 30 years.

MR. EDELMAN reviewed the three-member portfolio team that manages the ARMB account. The ARMB mandate is managed against the S&P 500. Research is the driver to the investment process. He reviewed the position RCM took two years ago in Apple and the position taken last year in Hewlett Packard when they were not seen as growth stocks. Research revealed that Apple would have some drivers, not only the iPod, but also the Macintosh computer. The Grassroots effort helped identify this. On Hewlett Packard, RCM knew the new CEO because of the former company he headed, NCR. The ability to clearly state his vision and execute on that vision made RCM enthused. RCM thought the share taken by Hewlett Packard would come out of Dell. While Dell is a great company, the market was expecting more than 20% earnings growth and was pricing that and RCM thought its earnings growth would decelerate.

MR. EDELMAN next reviewed RCM's investment process, which begins with a review of companies with superior management, proprietary product or services, barriers to entry so others cannot duplicate them, as well as good growth, quality, and valuation. He noted that AT&T is in the ARMB's portfolio because while it may not have seemed to be a growth company, it is in fact a growth company. AT&T can now compete with the cable companies because it can provide bundling. He anticipated this company would grow 14% to 16% over the next three years. This stock was bought in April at $24 and it is now $36. Valuation is an important element in the investment process. There is a time when a stock hits the target price and RCM moves on. RCM looks for transparency; RCM sold half of its position in United Healthcare last year because the CEO admitted there was post dating of stock shares. In December, the CEO of United Healthcare stepped down and the company continues to execute well.

MR. EDELMAN reviewed the performance of the ARMB large cap core growth portfolio. The calendar 2006 return was 8.88% compared to the S&P 500 at 15.79% and the Russell 1000 Growth Index at 9.07%. He noted that the Russell 1000 Value was up 22% in 2006. As a large cap manager, RCM focuses on healthcare and technology, but not on metals, energy, and commodities because they are cyclical companies with cyclical earnings. RCM's energy weight tends to be in the oil service side, not the large integrated companies. This hurt RCM in the fourth quarter. Exxon and Conoco were up 15% to 20% in the fourth quarter while Schlumberger and other oil service companies were flat or had negative returns. RCM has confidence in its performance going forward, based on past returns such as the 2005 return of 10.60% compared to the S&P 500 at 4.91%. Over the course of seven years, 10 years, and over the life of the portfolio, RCM has done a good job relative to the large cap universe and the index. The economy has stayed stronger than RCM expected, so there has been little reason to own growth names when value names have had better performance than expected. RCM believes earnings growth will come in below 10% rather than the high teens. In that environment, large cap growth stocks typically out perform.

MR. EDELMAN noted that in calendar year 2006 RCM was in the 26th percentile relative to other large cap growth managers, while the S&P 500 was in the top decile. He reviewed the ARMB portfolio relative to last year to show what has changed. RCM believes the portfolio is comprised of companies that should return 19% earnings growth relative to the broader market at 9%. In 2005, RCM was looking at over 20% growth while the market was growing at 13%. RCM has maintained its growth rate of approximately 20% while the market is decelerating. If a stock can be bought at near one times its growth rate, it should be purchased. Ultimately the market will look for companies that can execute.

MR. EDELMAN noted that the portfolio has good diversification across sectors. The portfolio looks at the best 50 or 60 names and builds the portfolio from there as opposed to imposing its view thematically. The top 10 holdings is a diversified list of large cap growth companies. Nearly 30% of the assets are in those 10 holdings. MR. EDELMAN noted that the portfolio holdings are outlined on page 18 of the summary presentation.

MR. EDELMAN reviewed the disparity between growth/value since 1979. He noted that style is cyclical and there are times when value is in favor or growth is in favor. Typically at the beginning of an expansion, value cyclical stocks are in favor as was the case in 2003/2004. As deceleration begins, large cap growth stocks come back into favor. RCM's market outlook is that corporate profits should be decelerating. The Federal Reserve is monitoring and they will do everything possible to get inflation down. Housing pressure appears to be abating. Energy has been an inflationary pressure, but that seems to be abating year on year.

MR. WILSON noted that an analysis shows that since 1982 value has out performed growth except during the tech bubble. MR. EDELMAN noted the peak in 1988 and explained there was deceleration and from 1994 through 2000 growth out performed. MR. ANDERSON noted that if the performance return to the peaks, the implications of that movement are enormous in terms of what it does to value and what it does to growth. MR. EDELMAN explained that the change is typically a four- to six-year cycle. MR. WILSON wondered what is the longer-term implication for portfolio construction when the gap between value and growth is closed. MR. EDELMAN stated an investor wants to have representation in both value and growth. DR. MITCHELL asked whether, despite the global sector fundamental research and Grassroots, it would be correct to state that RCM would do well only when growth is in favor. MR. ANDERSON replied that this would not be correct. RCM does well in an environment in which forces are neutral to positive for growth. MR. EDELMAN noted that in 2005 RCM outperformed by 400 to 500 bp and that was a value year. Positive stock selection is what RCM brings to the table. MR. ANDERSON noted that the analysis shows that in 2005 value versus growth was neutral. In that environment the firm did well. In 2006 there was an explosive movement of value relative to growth that translated into 1,300 points of differential.

8. Capital Guardian – Large Cap Equity

For more information on this presentation, please refer to the document entitled "A U.S. Large Capitalization Equity Review to Alaska Retirement Management Board," dated February 8, 2007 and kept on file at the ARMB offices.

PAULA PRETLOW and TERRY RAGSDALE presented to the Board after introduction by Gary Bader. Capital Guardian Trust Company (CGTC) runs international, emerging markets and other portfolios on behalf of the ARMB. Today's presentation is on the large cap equity fund. MS. PRETLOW introduced herself and Mr. Ragsdale. She reviewed the relationship profile between CGTC and the Alaska Retirement System. She explained that CGTC is a trillion dollar plus organization that is divided into two parts: the retail that is comprised as mutual funds (America Funds), and the institutional side where the ARMB assets are managed. CGTC is 75 years old, 100% privately owned, and investment management is its only business. The firm is truly global with ten investment offices located around the globe; headquarters are in Los Angeles. The firm was founded as a research organization. It is typical that the firm visits over 10,000 companies each year. MR. O'LEARY noted that these figures are for Capital Guardian, not the America Funds.

MS. PRETLOW stated the firm believes that cultural diversity leads to diversity of thought and opinions, to greater insights, and to better investment decisions over the long-term. Since the firm was founded in 1931 the story of the firm has remained the same. The objective is to produce long-term superior investment results for clients. The firm's philosophy includes the fact that Capital believes markets are inefficient and management adds value over time. If the correct stocks are chosen, the market will recognize value. The research at Capital is where portfolio management begins. The portfolios are managed by individuals who have the ability to invest in their highest conviction ideas, within a team environment.

The investment process has four steps. Each investment idea that is generated from research is vetted formally and informally through communication among investment professionals. Stock selection is done by seven managers and a slice is done by research analysts. Each portfolio manager chooses their highest conviction ideas and those are aggregated into one portfolio.

MS. PRETLOW stated it is important to have analysts involved in the investment process. Each of the managers is either value or growth or a hybrid of the two. The tenure of the team within the investment industry and at Capital is long.

MS. PRETLOW reviewed investment results for the portfolio, noting that over the lifetime of the account the returns are 12.68% net of fees compared to the S&P 500 at 10.50%. She noted that 2006 was a disappointing year. The S&P 500 had its best year since the 2003 cyclical recovery. Capital had an overweight in IT and financials, which hurt the performance of the portfolio. The positive attribution received from stock selection and sector selection was not enough to outweigh the things that hurt the portfolio.

MR. RAGSDALE reviewed the 2006 market in which the S&P 500 returned nearly 16%. Typically in a year with such a high return, investors are looking to take more risk in more volatile parts of the market. However, 2006 was a defensive year as people fretted about the economy. Typically there are a wide variety of market views at Capital, but in 2006 there was a distinct economic view that was different than the market. Capital was not worried about GDP or inflation, thought the consumer would hang in there, and thought that the housing market would have a shallow downturn. The more defensive stocks did well in 2006. Technology and healthcare did poorly in 2006. Investors wanted to avoid volatility in this paranoid market.

For 2006, Capital made some mistakes; while the fundamental views were correct, those views did not show up in the market. Capital did well in consumer staples and there were individual stocks across individual sectors that did very well. Capital was hurt by being over weight technology. In addition, there was exposure to consumer-oriented financials and those were unattractive in a market that was worried about the consumer. An even bigger financial detractor was owning Sallie Mae. Capital thinks the fundamentals of Sallie Mae are terrific, but it is subject to politics so with Democrats taking over Congress and wanting to cut student loan interest rates, it was hurt. Capital thinks it understands the political situation and what the risks are. Capital's analysis of the impact on Sallie Mae earnings is that it is relatively modest.

Consumer discretionary stock selection was a detractor. Getty Images had trouble last year and Lowe's was a consumer-related stock and the market did not want exposure to the consumer. MR. RAGSDALE summarized that there were some stock-specific issues, as well as broader themes where Capital wanted to be exposed that the market did not favor.

MR. RAGSDALE briefly reviewed the top 20 holdings in the portfolio. He noted that Capital is a bottom up stock picker and selects stocks based on research. Most of the time the firm chooses company-by-company, not sector-by-sector, so the current approach is unusual based on the company's distinct economic view. The firm owns 150 stocks, but the top 20 represent 38% of the portfolio. There is lower turnover with Capital than with many other large cap managers. Only one name in the top 20 was not owned at all one year ago.

MR. RAGSDALE reviewed the ARMB portfolio's diversification by sector. Technology has an 8 percentage point exposure above the S&P 500. This will likely have a significant impact on whether or not Capital does well in the coming year. Capital is invested in technology stocks after looking at the fundamentals of companies. Several things are happening in this sector. Capital is having a harder time than usual finding value-oriented names it wants to own in the technology sector. Capital is underweight financials, but there are approximately five large holdings. There are many names in the S&P 500 that are not owned, so there is an underweight. The yield curve is not kind to financial firms and the credit environment is bound to get worse. The portfolio is underweight energy, but is adding the names owned and putting them into oil and oil services; Capital is underweight oil companies and over weight oil services companies. There is 5% excess production capacity in the world now and OPEC is cutting production. In the 1980s and 1990s the oil companies under spent on capital spending and that has to change.

MR. RAGSDALE commented that the economy is good, corporate earnings rates are low, and there is cash on corporate balance sheets. Stocks have under performed earnings growth for the last several years, which should be good for the market. It is unusual for Capital to take a radical position on the market, which he did not intend to do, but he believed the market return might be double digit this year.

DR. MITCHELL asked if the 200 to 250 basis point excess return over the lifetime should be expected in the next ten to 15 years. MR. RAGSDALE thought the answer would be "yes." The firm is targeting 150 to 200 bp excess return on a gross basis. Capital is not trying to shoot the lights out. There is a natural diversification from seven portfolio professionals and 26 analysts. DR. MITCHELL stated that if there is quantitative or academic evidence showing that the number of analysts and the diversity of their background and the languages they speak is correlated to investment performance, he would like to see it. MR. RAGSDALE did not think there is academic evidence.

LUNCH BREAK 12:05 p.m. to 1:17 p.m.

9. Mondrian Investment Partners

For more information on this presentation, please refer to the document entitled "Presentation to Alaska Retirement Management Board, International Fixed Income Portfolio Management" dated February 8, 2007 and kept on file at the ARMB offices.

LEE GIANNONE, JOANNA BATES, and SOLOMON PETERS presented to the Board after introduction by Gary Bader. MR. GIANNONE introduced his colleagues. He reviewed the Mondrian organization, explaining that the fixed income team manages portfolios like the ARMB's and does the currency work for the equity teams as well. He explained that the firm's investment process takes the ideas of all the investment professionals to make a decision about what goes into a portfolio. Each team member assumes a very different role in managing the portfolio. There is an emerging markets team that is accessed for information, as well as a significant team of corporate analysts on the equity side. The only recent change at the firm is that Mondrian moved its offices to a building where the firm's growth could be accommodated on one floor in order to facilitate formal and informal interaction between professionals.

MS. BATES explained that Mondrian is a value manager, both in equity and fixed income. Value in global or international bonds is a forward-looking real yield, a prospective real yield, for each market. This real yield metric is used to asset allocate between the various countries the firm follows. Mondrian's process seeks to maintain the purchasing power of the cash flow of bonds after inflation. The inflation forecast is subtracted from the bond yield to determine real yield; the higher that number, the greater the value in a particular market. This approach tends to have good capital preservation characteristics, allocates risk efficiently, and provides an ability to forecast inflation.

MR. PETERS stated forecasting inflation is a key part to asset allocation in Mondrian. The firm takes both a quantitative and a qualitative approach to forecasting inflation, with a focus on the former. He concentrates more on the qualitative aspect in his position, creating inflation-forecasting models that are statistically valid representations of the data. Within that approach, the firm uses sophisticated statistical techniques. The models that are produced using the statistical techniques are rigorously tested against the data. Models are representations of the data and cannot represent structural changes. This is where qualitative analysis becomes important. If a significant event occurs in an economy, the data does not change, so the quantitative model will remain the same, but the model is overlain with a qualitative component to account for it. An example of this is in Poland where food prices spiked by joining the EU. The data did not indicate higher price inflation, but Mondrian predicted inflation would spike and then drop out a year later. Mondrian took a view that inflation in Poland was low, despite the temporary up tick, and decided to overweight Poland.

MS. BATES reviewed defensive characteristics that have resulted in out performance in up periods and less under performance in poor periods. She reviewed Mondrian's asset allocation relative to that of the index. This has been a good time for currency returns, particularly for some markets. Poland had a very good total return in 2006, up 18% in US dollar terms. Sweden was similarly good and it was over weighted. Australia was another market where Mondrian was overweight and it did well. The firm was underweight UK and it was a strong performer, largely through currency. Mondrian was also gradually moving to an over weight position in Japan and that was a lackluster market in 2006, driven primarily by currency weakness. Mondrian has been increasing exposure to Japan based on the belief it will perform going forward.

MR. SEMMENS asked for a description of currency analysis. MS. BATES stated that it is never clear if the excess return will come through the bull market or currency. Generally a position in a market is held unhedged for this reason. The Australian dollar did quite well last year and the bull market did not do as well, so returns were reaped through currency.

MS. BATES reviewed a recap of the performance of the portfolio. In 2006 international bonds achieved a 7% return in the portfolio, four basis points ahead of the index. The return out performed US bonds. Since inception nearly ten years ago out performance is around 1% annualized.

MS. BATES reviewed the firm's current strategy and investment outlook. Portfolios are constructed using a top down approach involving country allocation followed by currency analysis. A bottom up process involves security selection. Altogether the portfolio concentrates on high quality government bonds, but there are at times opportunities to invest in lower quality government bonds. The portfolio duration is typically between 75% and 125% of the index. In 2006 the portfolio has been short duration, which has benefited the portfolio.

MR. PETERS explained that the approach Mondrian takes to currency analysis is underlain by a pricing power parity analysis. This is an economic theory in which the price of the same product is compared in different locations. The firm calculates the fair value of an exchange rate using purchasing power parity. The actual exchange rate will hover around that value. Within that approach is a normal trading range for securities. Purchasing power parity gives up value at the extremes. When currencies are extremely over valued, people typically begin to hedge the currency. The time frame in which this happens is unknown. Mondrian has increased its exposure to the yen because it is far from its long-term theoretical value, but the time frame for it to reach its theoretical value is unknown. MR. PETERS reviewed an illustration of the purchasing power parity of the yen versus the dollar. The Japanese yen is currently trading two standards of deviation under value.

DR. MITCHELL asked if Mondrian takes positions in currency without a position in a bond. MS. BATES replied that the firm tends not to do so.

MR. PETERS continued with his presentation noting that the UK sterling is currently more than two standard deviations over value. There is a strong possibility this currency will depreciate in value.

MS. BATES reviewed country allocation in the international fixed income portfolio. There is a reasonable range of prospective real yields. The Alaska allocation is over weight Australia, Mexico, and Poland although the latter has come down over time and Mondrian sold it recently. There is an over weight to Japan primarily because the currency is under valued and there is a strong possibility of currency appreciation. The holdings are all high quality, government holdings and the spreads are tight. The yield to maturity is roughly the same as the index, duration is shorter than the index, and 90% of the holdings have a credit rating of triple A.

MS. BATES indicated that Mondrian's investment outlook is that the US bond market does not offer particular value at the moment as it has low prospective real yield and the dollar is at risk from weakness, primarily against the Asian currencies as well as other currencies. The firm is happy with the economic revival in Japan; it is a robust economic recovery with very low inflation.

MR. O'LEARY asked what is the inflation estimate in the US. MS. BATES replied that it is just under 3%.

MS. BATES stated that European inflation is likely to continue to fall. There are UK inflation risks and Poland had strong productivity, but the value is no longer strong. Australia has a benign bond market and Mexico has solid economic fundamentals.

DR. MITCHELL noted that occasionally one reads that France is tired of the euro and wants to pull out. MS. BATES said the UK is against joining the euro. The possibility for departure of a country within the euro zone is remote. The one country that has been concerned is Italy because it has higher inflation than average in the euro zone, which has driven down their competitiveness. There are arguments against them leaving the euro zone, however, such as interest rates going up substantially. Slovenia just joined the euro zone and going forward several other smaller countries will join.

10. ING Investment Management

For more information on this presentation, please refer to the document entitled "Portfolio Review, ING Ghent High Yield Fixed Income" dated February 8, 2007 and kept on file at the ARMB offices.

KENNETH MONAGHAN, TIM DOWLING, and THOMAS NEUKRANZ presented to the Board after introduction by Mr. Bader. MR. MONAGHAN introduced the members of his team and reviewed their backgrounds. He stated that the process for managing the ARMB's high yield fixed income portfolio is unchanged. The benchmark until recently was the Merrill Lynch High Yield Master II Index and going forward it will be the Merrill Lynch High Yield Master II Constrained Index. The performance for the year was under the objective, largely because of one bond. For the year the return was 10.52% compared to the Master II Index at 11.74% and the Master II Constrained Index at 10.76%. The benchmark has been changed for important reasons, not because it is easier to reach.

Le-Natures, a bottled water company, had a financial fraud, which negatively impacted the portfolio by 74 basis points. Without this investment, performance would have been 11.26%. MR. MONAGHAN reviewed month-by-month performance, noting out performance in the first half of 2006 and under performance in the second half.

MR. BADER clarified that the Board has approved a change in the benchmark and it is the Board's responsibility to set the benchmark. MR. MONAGHAN stated that rationale for the change in the benchmark was provided to Bob Mitchell and Gary Bader and ING requested that it be changed. MR. BADER stated with respect to Le-Natures that any action brought on behalf of this Board is brought by the Attorney General's office not an investment manager. MR. MONAGHAN acknowledged this. Le-Natures was a financial fraud that was not caught by Wachovia or two external auditors. Even the private equity investor board members on Le-Natures were not aware of the fraud. When the fraud was made apparent, ING sold the investments immediately. This is a company ING thought would be sold; there was a bid from another bottler for $1 billion twelve months earlier. Because neither the auditors nor the underwriter caught the fraud, there is a basis for litigation. A retainer is being drafted for a litigation firm and he has been in consultation with Mr. Mitchell regarding the prospects for litigation. He thought there was a substantial possibility of recovering a substantial sum through litigation. The litigation would take place on a contingency fee basis. There are a number of high profile investment management firms involved in pursuing this litigation.

MR. MONAGHAN reviewed the best and worst performers in the portfolio during 2006. Among the worst performers is Le-Natures at -67.6 basis point return and -74 basis points for the fourth quarter. The information provided to the ARMB gives detail on performance by industry. Aside from under performance in autos as a result of the under weighting of Ford and GM, most of the performance was based on security selection, rather than industry selection. MR. MONAGHAN briefly reviewed the characteristics and industry weightings of the portfolio. He explained that duration is an outcome more than an input into the investment process for high yield. The portfolio is heavily weighted versus the index in basic industries. The quality of the portfolio is B- on average. There is a heavy weighting in B rated bonds. Spreads are very tight at this time. The portfolio is slightly over weighted in CCC; a number of these bonds are expected to be redeemed in the first six to nine months of 2007, so that number should be coming down.

By moving from an unconstrained index to the Master II Constrained benchmark the limitation on any one individual issuer will be 2%. That became a problem in 2006 for all high yield bond managers because GM and Ford were downgraded into high yield and had such a big impact on performance that they overwhelmed the index. The bonds of GM, GMAC, Ford and FMCC comprised nearly 11% of the Master II Index, but only 4% of the Constrained Index. Because the portfolio is limited to 5% holding of any issue, the change to the Constrained Index is desired. MR. MONAGHAN noted that ING uses a composite index to compare itself to peers in the marketplace. The composite index return was 9.83%, whereas the Alaska return is 10.52%. Versus its peers, ING was at median for the high yield industry in 2006. Historically ING has been an above average manager, but being an average manager in 2006 is okay.

MR. DOWLING stated high yield bond spreads have moved to their tightest point in recorded history since the 1990s. Risk premium in many products is depressed and high yield is just one of those products. The reasons for the tight spreads are various. Fundamentals are strong. Investment is a challenge when there is a great deal of money coming into the market. Calls, maturities, and other redemption features have been eating away at high yield so there are more buyers than sellers.

MR. O'LEARY thought everyone would question why, if the low yield spreads are unprecedented, a bond investor should not go to the sidelines. He asked why ING should not go to the sidelines and why would ING have below average quality. MR. DOWLING responded that ING believes the economy is in good shape. Fourth quarter GDP was surprising and high yield spreads are tight, but the amount of money to be made from a high yield portfolio will be a function of both Treasury rates and spreads staying tight or getting even tighter. He expected the economy to remain solid, the default rate to be level, and the forward default rates to be low. He believed that credit spreads would not back off much and interest rates will not rally significantly from current levels. MR. MONAGHAN added that ING has met with consultants and high yield market strategists to understand what prospective yield the market should generate in 2007 and everyone clustered around 4% to 6%. That yield implies a Treasury return of zero, slightly negative, or slightly positive. ING is hedging its bets by having a small portion of the portfolio in floating rate notes and a small portion is in bank loans.

MR. DOWLING stated lower rated issuance leads to increased defaults. The portion of CCC paper being sold into the market has been increasing and over time that will lead to increased credit losses. The high yield credit cycle appears to be 10 years in duration and there is some time left to remain active in the lower quality realm of the market.

MR. DOWLING reviewed a chart depicting the match of default rates to tight spreads. The biggest losses will be highly leveraged LBOs in the future, but there is not a significant risk in that part of the market to lead to a significant decline. ING believes demand is greater than supply across many risky assets. Tight spreads will exist in high yield for the balance of this year. Loan issuance has grown and much of the credit market expansion has been in the loan product, not the bond product There could be some trouble in this area, but there are also opportunities. The consensus view for 2007 is economic growth of 2% or less due to a weak housing sector, that the Federal Reserve would cut rates, and that the more actively traded bonds would yield at the 4% level. Instead ING notes that the 10-year Treasury yield is at 4.75%. ING does not see a Federal Reserve cut and believes that defaults and credit losses will remain low, spreads will stay tight, and high yield returns will be moderate in comparison with last year.

MR. MONAGHAN stated that the firm's performance in 2006 was not what it expected, but it was about that of the average high yield manager, while less than the index. The firm is watching the credit market to turn in terms of default risk, but does not expect this to occur until 2008. In the interim, the firm is looking at BB bonds selectively, but there is not much opportunity because spreads are tight. The firm is focusing on B and selectively on CCC. The firm will continue to overweight B and watch the risk of CCC and it has been selectively investing in loans.

11. MacKay Shields LLC

For more information on this presentation, please refer to the document entitled "Alaska Retirement Management Board, Investment Review" dated February 8, 2007 and kept on file at the ARMB offices.

ALLISON BENNETT and MIKE SNYDER presented to the Board after introduction by Mr. Bader. MacKay Shields is a high yield fixed income manager for the Board. MS. BENNETT explained that at the end of 2006, the firm managed a total of over $40 billion, $16 billion of which is in the area where the ARMB is invested. On January 16, 2007 Oswart Hood joined as Chair and will work with the day-to-day management of the firm. This has no impact on the management of the ARMB's portfolio. She noted that the benchmark was changed to the Merrill Lynch Master II Constrained as of this year.

MR. SNYDER stated that despite modest expectations for 2006, the market performed well with returns of 11% to 12%. This was due to a strong economy, low default rate, and strong corporate earnings and cash flow. This was a stable environment that the credit markets enjoyed. The firm had strong returns for the year using a bottoms-up approach to credit. Since inception in April 2005 the fund has under performed the Merrill Lynch Master II Index, which was a function of the ramp up period of the portfolio in May-July 2005, which was a robust period for high yield. There was another instance at the end of 2006 when there was an inflow and as that ramped up, there was a lag. The portfolio value was $136 million at the end of the year, with roughly 90% invested in the high yield market. There has been a cash balance of 8% to 10% through the course of the year based on the view that there were few relative value opportunities in the market. Currently the cash is 7% as new issues came available at the beginning of the year.

MR. O'LEARY asked for comment on equity being in a high yield bond portfolio. MR. SNYDER indicated that for the most part this includes preferred stocks. He explained that in different market environments there are transactions called unit deals that are part bond and part equity. There are some instances where small baskets of equities are put into high yield portfolios.

MR. SNYDER stated the firm's approach is bottom-up and credit intensive. There is a correlation between how a credit is viewed and perhaps how an industry is viewed. Using health services as an example, where there is an over weight, there are three substantial holdings. In energy, the exploration and production sector is favored and represents a diversified group of companies. The automotive sector is under weighted, both in OEM suppliers and in Ford and GM. There is an over weighting in GMAC, which was spun off from GM. GM and Ford corporate credits did well last year, but there are concerns for domestic auto production and there are not adequate returns.

MR. SNYDER reviewed duration, yield to worst, and average quality for the Alaska portfolio compared to the benchmark Master II Index. Top performers included airlines, particularly Delta and Northwest, and GMAC. Capacity was taken out of the airline sector and there were labor concessions, which along with a strong demand environment resulted in a financial recovery in that sector. He remarked that airlines are ripe for consolidation. The bottom performers in the portfolio were Magnachip Semiconductor because it lost a contract with Nokia, Collins & Aikman Products that makes interiors and products for automobiles and they have tremendous exposure to domestic OEM, and Lumbermens Mutual Casualty.

MR. SEMMENS asked if a typical merger and acquisition aids or hurts a bondholder. MR. SNYDER replied that in many instances in a high grade market there is event risk because the credit spreads are relatively thin and there are not protective covenants to protect on the downside. For the most part, in a high yield market it is helpful because the holdings are the targets of the acquisition. MR. O'LEARY clarified that a leveraged buy out is bad for corporate bonds, but for high yield it can be a benefit.

MR. SNYDER stated that currently there are narrow risk premiums, which is good for the economy. The default rate last year was 1% and it is expected to be less than 1% this year. The differential between higher grade and lower grade credits is low. MacKay Shields has been inspired to rotate out of risk and take a higher quality orientation to the marketplace. Major risks that exist include financial leverage in the marketplace, the fact that the credit default market has grown, and the fact that the CBO market has exploded. These risks have not been priced into the market, but it exists. The economy is a risk, although people are comfortable. There is always geopolitical risk. If the market remains as it is, MacKay Shields will track or modestly under perform and, if the market corrects, the portfolio will out perform dramatically.

MR. SNYDER noted there have been some staffing changes at MacKay Shields. The team is seasoned. Its members have an average of 20 years of experience in the industry. Matthew Philo is a 10-year MacKay Shields veteran and the Senior Managing Director of the high yield investment team. The firm quickly attracts highly qualified individuals for its team.

MR. SNYDER reviewed the firm's investment process. MacKay Shields looks at the 2,000 companies in the high yield universe, screens companies out using a minimum yield requirement of 200 to 250 bp over Treasuries. There is also a liquidity requirement. The firm uses a financial analysis screen to identify companies with a discount to their asset value and strong free cash flow characteristics. Business judgment is a qualitative analysis to determine management's intent for the business, what is the strategic approach of the company, and what is its momentum. The final screen is whether there is a catalyst in place that helps realize value. These screens produce a universe of 300 companies to which MacKay Shields applies its risk analysis to ultimately develop a 110- to 130-issue portfolio.

MR. SNYDER stated the high yield asset class is reasonably valued versus other fixed income asset classes. High yield has a high current yield, relatively low duration, and a low correlation to other asset classes. MacKay Shields segregates risk into four groups. Group I are the highest quality credit issues that have a minimum spread premium, which is slightly over 7%. Group II has strong asset coverage and may or may not have strong free cash flow characteristics, but have strong business and franchise value, yielding slightly over 8%. Group III have stories behind them; they require more credit work. If the asset coverage is not 1.5 times, it is not considered; these issues yield slightly over 10%. Group IV are special situations or restructurings where there is a significant discount to asset value. In a normal environment Groups I, II and III are the majority of holdings. In the current environment, the overall portfolio quality has been increased and there is an 8% over weighting in Group I, a 9% over weighting in Group II, and a 16% under weighting in Group III. The firm has been successful over time because of discipline and a consistent process. MR. SNYDER noted there is tremendous complacency in the market. The firm's process requires that it rotate out of risk when the compensation is not sufficient. It is possible that the firm can under perform this year but at the end of the day the objective is to out perform when the market under performs.

MR. O'LEARY recalled that when the firm was hired it was nearly closed to new business. MR. SNYDER stated the firm is closed, but there is special consideration for existing clients. The firm thinks that $16 billion is sufficient size and managing more could hurt existing clients.

BREAK 2:45 p.m. to 3:05 p.m.

12. Investing in Timber

GEORGE WILSON, Investment Advisory Council member, stated timber investment is an emerging asset class and there is a great deal of interest. For eight years he was a senior investment officer at the Massachusetts pension plan PRIM, initially responsible for real estate and private equity. Dr. Mitchell gave him responsibility for the plan's timber investment. Timber is real estate by definition, but it is not similar to real estate investing at all. When one invests in timber, one is investing in trees, there is not a predictable cash flow stream, and it is tied to the economy.

MR. WILSON stated that Harvard and CalPERS were the leaders in timber investing in the 1990s. In the mid-1990s the Harvard Endowment put up to 15% of their investable assets in timber, which worked well for them. PRIM was the third significant player and today has the largest separate account in the industry.

Forest products is a global industry, with the US having the dominant position producing 27% of forest products globally. The US dominance is a function of the fact that there must be roads in order to transport trees and there must be affordable transportation connections to sawmills and paper mills. From an institutional standpoint, the investable universe is 77% US and 23% international. Production in the US has changed with mills relocating to the south and no new mills being built over the last 15-20 years. South America and Brazil are upcoming markets.

MS. HARBO asked for comment on bamboo as a product. MR. WILSON stated there are alternatives in the forest products industry, but he has not learned much about bamboo because it is not grown in the US. There are many unique things going on in the world in terms of technological advancements. All of these factors present risks to the timber industry. He noted that the market value of the timber market is smaller than the market cap of Microsoft. Of the $230 billion timber market, 75% is owned by individuals so the market is $25 to $50 billion in investable assets, which is evenly spilt between institutions and forest product companies. Forest product companies continue to divest themselves of the direct ownership of timber because they can re-allocate their resources into higher producing equities.

MR. WILSON explained that timber is located primarily in the South and Northwest US. There are specialty woods in the northeast. A timber portfolio will be diversified by area of the country, what point the timber is in the growth cycle, the location of the timber, and other variables. In the Pacific Northwest, the high value soft woods are Douglas fir and Hemlock. Products are high quality dimension and structural lumber with a growing cycle of 40 to 50 years. In the South the Southern Pine is the dominant tree. The growing cycle is 25 years. The main use of this timber is pulp for the paper industry or lower quality framing lumber.

The large institutional owners in this market include Plum Creek, a publicly traded REIT, as well as Manulife, the owner of Hancock Timber, Massachusetts PRIM, Harvard, the Bill & Melinda Gates Foundation, Yale, Princeton, CalPERS, and closed-end commingled funds.

COMMISSIONER GALVIN asked the size of Massachusetts PRIM and what percentage of the portfolio is represented by timber. MR. WILSON replied that the total portfolio is roughly $45 billion total and their investment is roughly 4%. In this market, there is more cash than there are deals for investment.

MR. WILSON stated there are five or six major players in this industry, most of which offer commingled funds. The return expectations are not dissimilar from real estate, but the return components are different. The objective is to have a regular cash flow over 20 years so investments are structured to bring in a regular annual return over that time period. Total returns for timber are 7% to 8%, unleveraged. Selling a tree at a greater age yields a greater return.

Over the last five years, the timber industry has returned 7.8% compared to 4.8% for bonds, 8.1% US stocks, and 12.4% for real estate. There is underlying inflation protection with this asset class. Over the last 10 years, timber has returned 8.6% compared to 6.4% for bonds, 8.7% for stocks and 12.5% for real estate. Annual returns have been volatile in this asset class. The returns in the early 1990s were high and were not indicative of this asset class. MR. WILSON felt that a reasonable return expectation is 7% to 9%. Historically, timber has not been correlated to other asset classes. This asset class does have different economic characteristics that make it attractive in terms of diversification.

Trends in the industry include consolidation in the forest products industry, growing global competition, technology changes in the forest products area, and better forest management techniques. There are a number of risks as well, including commodity pricing, acquisition price, environmental regulations, international competition, trade barriers and tariffs, natural disasters, technological changes, and the fact that timber is not a scarce resource.

MR. BADER asked what percentage of return tends to be yield and did Massachusetts PRIM have a yield expectation when it invested in timber. MR. WILSON replied that yield is property-specific. Mature stands sell for a different return than newer stands; mature stands have a very good cash flow. Generally in today's environment yield is 3% to 5%. MR. BADER noted that Massachusetts PRIM was able to buy a portfolio, so there was probably good diversification from the beginning. He asked whether, if the ARMB decides to invest in timber, would a commingled fund be preferable to separate account. MR. WILSON felt this depends on the ARMB's long-term objective. If the ARMB wanted 3% timber in a bucket of assets and it should be diversified, it should be commingled. On the other hand, if the ARMB wanted to put a higher percentage in this asset class, an individual account could be done. It could also be done in stages, which was done at Massachusetts PRIM.

MR. WILLIAMS asked whether, if the ARMB were to increase its asset allocation in timber, it should also consider international markets. MR. WILSON stated he is intrigued with international investing. He did not recommend it because he wants to see people with demonstrated records. Some entities can handle volatility, but it can be politically difficult. The situation in New Zealand was interesting a couple of years ago and high profits could be taken. Massachusetts PRIM looked at it, but it was a complex transaction that required a lot of money and they did not ultimately invest. He guessed with the dollar devaluation over the last couple of years, the five-year numbers from international timber would probably look good next year.

MR. O'LEARY had a sense that foreign activities have a large component of private equity because it is also constructing the infrastructure. MR. WILSON agreed with this point. He noted that sometimes the investor is going into business with an entrepreneur who is building a mill and the investor is buying the plantation. MR. O'LEARY commented that this is a different set of risks than buying established timberland in the US.

MR. WILSON summarized that returns for timber are competitive, they have a low correlation to other asset classes, and the returns are decent. He stated that in today's marketplace there is unbelievable liquidity and risk premiums are unusually low across all asset classes.

MS. HARBO noted that one of the greatest uses of pulp is disposable diapers.

13. Investment Taxation Issues

CHAIR SCHUBERT indicated that this discussion should be conducted in Executive Session.

TRUSTREE WILLIAMS moved to go into Executive Session for the purpose of receiving advice of counsel. TRUSTERE HARBO seconded.

There being no objection, the motion passed unanimously.

EXECUTIVE SESSION 3:35 p.m. to 4:00 p.m.

14. Health Reimbursement Arrangement Plan

GARY BADER explained that Section 80 of SB 141 established the Health Reimbursement Arrangement Plan for PERS and TRS. It states, "…that for each member of the plan, an employer shall contribute to the teachers' and public employees' retiree health reimbursement arrangement plan trust fund an amount equal to three percent of the employer's average annual employee compensation." The statute further requires "that the board shall establish by regulation the rate of interest to be applied annually to the amount in a member's individual account." DOR and DOA staff have worked on this for quite some time. Setting a rate seems like a fairly easy thing to do; however, any rate that is set is subject to the non-diminishment provisions of the Alaska Constitution. Mr. Mitchell and his staff worked with him and did modeling in an attempt to set this rate in a manner that was responsive and implemented what the Legislature envisioned in terms of a crediting rate related to the market rate of funds and in such a way that the Fund is not at a disadvantage to the investment markets in years to come. The Legislature intended that this account be self-supporting. A proposed regulation has been developed to establish a way of calculating earnings on the account, posting those earnings annually, and establishing another account that would accumulate funds to account for the expenses and reinstatements of the plan. The draft regulation does not have to be adopted by the ARMB today, but staff asks that the ARMB approve the issuance and notification that regulations are pending before it to begin a time period for public review and comment. These regulations are envisioned as a starting point for discussion with the ARMB members. The regulation would not be brought forward for final adoption until the ARMB's April meeting.

MR. JOHNSON explained the regulation process requires that there be publication in newspapers and the like and there be a 30-day period for public comment. At the time of adoption, the Board would consider public comment and make any changes it deemed appropriate. These regulations would then go to the Attorney General's Office for final vetting and publication in the Alaska Administrative Code. The ARMB could not legally take action on the regulation today because this process has not occurred.

MR. BADER noted that item (i) would set the crediting rate for the 2007-2010 at one percent. Not setting the rate forever would give an opportunity to fill up the expense and reinstatement account with enough dollars to meet the needs of the fund in the future. It is also not anticipated that anyone would access this account. Third, beginning in 2011 if there were surpluses in the account, those would be part of the earnings computations. Generally, no one can access this account for ten years.

COMMISSIONER KREITZER asked how regulations would be disseminated and whether they would be supplied to all legislators and municipalities, or through any other means than online notice. MR. BADER stated that dissemination would be done in conformance with how all regulations are done. COMMISSIONER KREITZER suggested that because this would be a fix to SB 141 the regulations be disseminated to all legislators, to municipal finance officers, and to anyone else involved in this issue.

MR. SEMMENS moved that the ARMB approve beginning the regulation adoption process. MS. HARBO seconded.

By roll call vote, the motion passed unanimously.

MS. HARBO asked if the calculation for the employer's average annual employee compensation uses actual number of employees or full-time equivalent (FTE). MS. MORRISON replied that the basis is FTEs. MS. HARBO noted that this calculation really helps lower paid employees.

15. Calendar Review

MS. HALL noted the calendar is in the packet. The meeting sites are tentative. Because the Audit Committee is meeting in April and they want to meet with the compliance staff at DR&B and Treasury, the ARMB's April meeting location is Juneau. The other meeting locations have not been finalized.

MR. SEMMENS favored holding the September meeting in Fairbanks.

COMMISSIONER GALVIN asked if the April date could be moved earlier in the month in order to allow for legislative visits. MS. HALL believed the prior week there was a conflict and perhaps the APFC has a meeting in April around which the ARMB's meeting is being scheduled. The dates were set about four months ago, so she could not recall why that date was chosen. MS. HARBO recalled that the date was set later in April because of conflicts with other meetings. COMMISSIONER GALVIN noted that if the House sticks to their 90-day schedule, they would be out of session on that date.

CHAIR SCHUBERT suggested that the June 14-15, 2007 meeting location could be Kenai.

TRTUSTEE KREITZER noted that many people are traveling from Juneau for the ARMB's meetings and the expense is significant. In her four years of work with the Senate Finance Committee she is aware there was a close examination of the APFC's travel budget. She had concern with expenditure of funds when there is a huge unfunded liability in the pension funds. She felt that either Anchorage or Juneau would seem the best locations in order to keep costs down. CHAIR SCHUBERT suggested tentatively scheduling the June 14-15, 2007 meeting for Anchorage.

COMMISSIONER GALVIN noted there is not much public in attendance in Anchorage and questioned whether people take advantage of attending meetings in other parts of the state. MR. TRIVETTE noted that oftentimes there is better attendance in Anchorage than at today's meeting, perhaps because of the specific agenda items. COMMISSIONER GALVIN asked if there is a perceived value in making the ARMB available in person in different part of the states. MR. TRIVETTE recalled the PERS/TRS/ASPIB meeting in Fairbanks in 2004 where there were dozens of attendees. He agreed that attendance might depend on the agenda.

MR. SEMMENS thought that holding meetings in larger state communities offers the opportunity for those people to see the ARMB. He agreed that attendance is agenda driven.

COMMISSIONER KREITZER was unwilling to commit to locations beyond April, wanting to understand how agendas will be structured and whether a particular agenda is more appropriately heard in Juneau or Anchorage, for instance.

CHAIR SCHUBERT noted that the June meeting is in the middle of tourism season, so it is important to get the location firmed up in order to reserve the meeting space and rooms. She asked how many months in advance this must be planned. MS. HALL replied that it would be critical to schedule the June meeting soon. CHAIR SCHUBERT suggested Anchorage for June, Juneau for April, Fairbanks for September, and Anchorage for November.

16. Transfer to DCR Plan by Non-Vested DB Plan Members

MR. BADER stated AS 39.35.940 (f) and AS 14.25.540 (f) provides that the Alaska Retirement Management Board adopt regulations to establish transfer procedures for non-invested members of the defined benefit plan…" On June 22, 2006 the commissioner of the Department of Administration adopted emergency regulations (AAC 35.138) to set out procedures. Those emergency regulations became permanent, however, the statute provided that the regulations should have been adopted by the ARMB. Those regulations have been provided to the ARMB with a recommendation from the DOA to modify item (c) slightly to accommodate an interest they have by adding "under AS 39.35.750(a)." To be compliant with the statute, the ARMB needs to adopt these regulations in some fashion.

MR. JOHNSON suggested that the ARMB would have to go through the regulation adoption process in order to adopt these regulations. He suggested the ARMB either adopt these regulations or adopt a regulation adopting the regulation that was previously adopted. Because a change is proposed to section (c) he felt the regulation should simply be rewritten, which would satisfy the ARMB's statutory requirement.

MR. TRIVETTE <u>moved that the ARMB authorize adoption of this regulation and begin the regulation adoption process</u>. MS. HARBO <u>seconded</u>.

By roll call vote, the motion passed unanimously.

RECESS 4:33 p.m.

ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

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

MINUTES OF
February 8-9, 2007

Friday, February 9, 2007

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
Sam Trivette
Gayle Harbo
Gail Schubert
Larry Semmens
Patrick Galvin
Mike Williams
Annette Kreitzer

ARM Board Members Absent
Martin Pihl

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

Department of Revenue Staff
Brian Andrews, Deputy Commissioner, Department of Revenue
Gary Bader, Chief Investment Officer
Bree Simpson, Assistant State Investment Officer
Susan Taylor, Comptroller, Treasury Division, Department of Revenue
Judy Hall, ARMB Liaison Officer, Department of Revenue

Department of Administration Staff
Annette Kreitzer, Commissioner, Department of Administration

Melanie Millhorn, Deputy Commissioner, Department of Administration
Charlene Morrison, Chief Financial Officer, Division of Retirement and Benefits, Department of Administration

Department of Law
Mike Barnhill, Department of Law

IAC Members
Jerrold Mitchell
George Wilson
William Jennings

17. University of Alaska

MR. BADER noted that Ms. Pat Pitney with the University of Alaska presented comments to the Board at its last meeting. The Board was given her written comments. She was asked to return and address the Board.

PAT PITNEY, Vice President, University of Alaska, explained that the University's proposal requests that rather than passing the funds through the budgets of the K12 and the university system for TRS, the funds go directly to the retirement system. This maintains the current retirement level rate, which leaves the University competitive in the research field. Going from 26% to 54% would threaten that competitiveness. From the ARMB's perspective this solution creates a more stable funding mechanism. In terms of the other proposals for retirement, Mr. Lamb will speak later in this meeting about an 85/15 proposal, and there is discussion in Juneau about separating past cost rates from current liability. Both of those ideas would be good solutions and the University is not advocating its solution over those. The solution the University proposes is positive for all parties and can be implemented easily and immediately.

MS. HARBO asked why the University's letter references an annual payment, as she understood the FY08 appropriation is one-time. MS. PITNEY stated the PERS municipal payment is $77 million and it is one-time only. The TRS has been $170 million on the education side and there are operating base funds in the operating budget. It would be in the operating budget, and would become a base annual commitment. MS. HARBO noted that teaching staff is comprised of either TRS or adjuncts and the latter have no benefits. She asked how many adjuncts are associated with the University. MS. PITNEY replied there are 1,200 adjuncts. MS. HARBO asked how many TRS employees are associated with the University. MS. PITNEY replied that there are 850. MS. HARBO asked how many TRS employees are in Tier 1 and how many are in Tier 2. MS. PITNEY replied there are 850 in Tier 1 that is tied to the TRS employer contribution rate. In 2005 when the employer rates were raised, the ORP was closed and a new Tier 2 ORP was put in place with a 12% employer contribution rate. MS. HARBO understood there were no Tier 2 employees because ORP was implemented in 1990. MS. PITNEY replied that ORP is an optional retirement system. She did not have the exact figures for TRS Tier 1 and TRS Tier 2. She believed that of the roughly 1,000 TRS eligible employees, Tier 1 is slightly higher, but the split between Tier 1 and Tier 2 is close to 50/50. It is an employee's decision whether they enter TRS or ORP and they cannot transfer between the two. MS. HARBO asked what is the contribution rate to ORP for the 401(k). MS. PITNEY stated the original ORP is tied to the TRS participating employer rate. MS. HARBO asked whether there is a maximum. MS. PITNEY replied in the negative. MS. HARBO understood that if this were passed, under the original ORP the University would have to contribute 54% of salaries to the 401(k). MS. PITNEY explained that it runs on a three-year lagging average of the TRS employer rate, so within three years the 54% would be paid. In 1990 the Tier 2 ORP was established in order to provide an attractive alternative to the TRS system. MS. HARBO understood that adoption of the University's proposal would leave the employer rate at 26% and the ORP participants in Tier 1would be denied an increased contribution. MS. PITNEY stated that because it is based on the TRS employer contribution rate, they are not denied anything, because it is based on what every participating employer is paying. Because the rate would be based on a precipitously declining population, the rate becomes exponential and unrealistic. MS. HARBO explained her concern is that she would not want to see one employer group denied benefits that they were promised. MS. PITNEY stated they would receive the benefit based on a TRS participating employer rate.

MR. WILLIAMS stated there are maximum contribution limits to 401(k), 403(b) or 457 plans of around 20% of salary. He supported whatever the Legislature appropriates to pay down the unfunded liability, but noted that there is no guarantee of an appropriation. He asked how contributions would be gained from employers if the employer contribution rate were not increased. He asked how employers would be held liable for what they owe. MS. PITNEY believed that all of Mr. Williams' statement applies to the PERS system where the individual employer holds the liability. From the TRS perspective, the liability is at the state level, not with individual employers. Mr. Williams' assumption on the appropriation is a valid concern. The ARMB would have to have assurance that a rate difference is dependent on legislative appropriation. As the appropriation bill has been forwarded, that funding is being recommended. Traditionally the cost of TRS employer rate increases has been borne by the State almost in its entirety.

MS. HARBO thought when there was a large increase in the employer contribution rate in recent years the Legislature appropriated funding to cover the difference. MS. PITNEY stated they have consistently appropriated for the majority of cost of this program.

MR. TRIVETTE asked what provision ORP is under. MS. PITNEY was not aware, but indicated she could find out.

MR. SEMMENS asked if the ARMB is fiduciary to the ORP plan. MS. PITNEY replied in the negative.

COMMISSIONER GALVIN understood this issue would be addressed by resolution later in this meeting. CHAIR SCHUBERT indicated this is the case.

DAVID TEAL, Director of Legislative Finance, indicated that while he could not make representations on behalf of the Legislature, he wished to clarify that the Legislature faces some choices. TRS is a shared liability system so there can be only one rate. As proposed, the school districts are funded outside of the formula and contributions go to the DOA. That would leave their rate at 26%. If money goes directly to the University and other small groups of employers, their rate would be 54%. The Legislature has the choice to either move all of the money outside of the agencies and fund all of it directly to DOA, or none of it. If the Legislature were to fund the TRS system by direct deposit to the TRS account and the rate were not lowered from 54%, then the University and the school districts would be required to pay 54%. The Legislature needs some assurance that the ARMB can and will reduce the rate depending on how much the Legislature funds directly to the DOA. He stated he has spoken with DR&B about this issue. The Legislature has to put all funds either in or out of the system.

MR. TRIVETTE asked whether Mr. Teal has seen the ARMB's proposed resolution. MR. TEAL replied in the negative. MR. TRIVETTE asked that Mr. Teal be supplied with the resolution in order that he might comment on it.

18. Capital Markets Assumptions

For more information on this presentation, please refer to the document entitled "2007 Capital Market Review and Asset Allocation Policy Implications" dated February 2007 and kept on file at the ARMB offices.

MICHAEL O'LEARY with Callan Associates, Inc. (CAI) indicated that the written information provided to the Board explains that in developing its capital market assumptions, CAI tries to create a set of reasonable objectives for major asset categories that are independently reasonable, but work with one another. The typical investor thinks of asset allocation in a much shorter-term manner than the asset allocation work CAI does. The estimates are not precise. He encouraged the ARMB to think of there being only two asset classes, cash and equity, and everything else is sub-derivative of those two. For instance, high yield bonds are longer-term debt obligations and, therefore, a variant of cash. Because the risk level is so high, they also have an equity component. Emerging markets stocks are stocks, but they are higher risk because they are in emerging markets and there is also currency risk. Over the short-run the differences in these sub-derivatives are great, but in the long-term they are not.

MR. O'LEARY reviewed the rolling 5-year return for the S&P 500 from December 1926 through December 2006 and noted the volatility of returns over time. Since 1977 the average rolling 5-year return has been 12.4%. The average rolling 3-year return has been 11.53%. An analysis of the volatility of rolling 5-year periods shows that at the end of 1998/1999 the volatility was very low at less than 10%. Volatility measures the standard deviation of annualized returns and increases when there are ups and downs in market performance; however, at that time period the market was rising so volatility was low. The average volatility over the 1977 through 2006 history of the market has been 15.94%. The most recent three-year volatility would be much lower and that is what managers address in presentations today. When CAI is doing planning, it is considering long-run volatility.

The average P/E over the period 1954 through 2004 is in the high 16% to 17% range. In the early 1980s P/Es were below 10% because interest rates were above 10%. P/E ratios were very high in 1999/2000, but they now appear to be at a reasonable long-term average. So long as earnings are not expected to decline, the conclusion can be made that the stock market is not over valued.

Reviewing a comparison of the S&P 500 earnings yield to the 10-year Treasury bond since 1981 MR. O'LEARY noted that the 10-year Treasury had a yield of over 14% in 1981, which made bonds attractive to investors. The ratio of S&P 500 earnings yield and the 10-year Treasury indicates that stocks are cheap compared to Treasuries. In the 1950s the dividend yield on stocks exceeded that of Treasuries. This type of analysis worked well from 1980 until recently. Since 2001/2002, however, interest rates have gone lower while earnings have done exceedingly well.

The rolling 5-year return for international stocks in 2006 is 14.98%; the average is 11.02% since 1977. During the most recent 5-year rolling period, stocks in Japan did exceedingly well. The typical active manager lost to the index during this time period. Emerging markets have been one of the best performing markets in the last five years with a return of 26.97% in 2006. From 1999 through 2003, the emerging markets return was -5%.

MR. O'LEARY reviewed the rolling 5-year return for the Lehman Brothers (LB) Aggregate bond index. Over the last five years the return has been slightly over 5%. Over the long-term it has averaged 9.3%. He believed the 9.3% average has no relevance today. Returns were so extraordinary in the 1980s because interest rates were high, but declining, so the value of existing bonds increased.

Graphing the total return, income component, price change, and residual of the LB Aggregate from 1976 through 2006 indicates that the income component is reasonably stable and always positive and the price change is significant.

CAI believes that if income is the primary source of return over time for the bond market, the current income level for the bond market can be used as a strong predictor of future returns. The yield to worst closely tracks the trailing 5-year return for the LB Aggregate. The yield to worst is pushed ahead five years in CAI's analysis so that the yield to worst on the LB Aggregate at the end of 2006 was 5.34%. MR. BADER asked that the term "yield to worst" be explained. MR. O'LEARY explained that if a corporation issues a bond at 8% and after 5 to 6 years interest rates have come down so that if they were issuing a bond at that point they would be paying only 6%, they would not try to recall the bond and issue another one. The yield to worst presumes that in fact the bond would be called.

MR. O'LEARY reviewed cash returns based on a rolling 5-year return for 90-day Treasury bills from 1926 through 2006. Today the cash return is 3.94%. Returns were very high in the early 1980s and were low prior to that. There is debate what return over inflation should be expected from cash. There have been times when cash has produced a return that is lower than inflation, but most of the time it has been positive. It has seldom been as positive as it is today.

MR. O'LEARY next reviewed real estate. He stated that the value of this asset class is impossible to accurately measure. The ARMB's real estate consultants use the NCREIF Index, which is appraisal-based and unlevered. CAI's real estate database shows the returns of institutional investment products. Using CAI's database, the rolling 5-year return from 1977 through 2006 is 8.15%. Using the CAI database, the variability of returns is calculated at 1.94%. However, it is not commonly thought that real estate is less risky than investment grade bonds. For this reason, CAI uses an equity-like risk number and a correlation number in its analyses in order to yield a reasonable result. Standalone real estate consultants modify their risk figures using the standard deviation number and the correlation number.

MR. O'LEARY stated that for the five years ended 2003 the NAREIT Index had a return of less than 5% over the prior five years, so there is apparent volatility. REIT volatility is much higher than real estate in general at 14.92%.

Inflation (CPI) from 1978 through the end of September 2006 has come down, but is above its historical lows.

CAI's 2007 capital market projections are modestly changed from last year. The inflation estimate is maintained at 2.75%. That estimate is slightly higher than the consensus, but last year it was lower than the consensus. In response to a comment by Mr. Trivette, MR. O'LEARY stated that any actuary thinking of inflation is using a higher number than CAI in order to be overly conservative. The actuary is scheduling payments to meet future obligations that are dependent on the level of future salaries and theoretically those payments have to be made before the participant retires. This creates an issue for the ARMB and other fiduciaries because there is a gap between the inflation estimate of the actuary and that of the investment consultant.

MR. O'LEARY further summarized CAI's capital market assumptions. Cash returns are 4%, or a real return of 1.25% based on the inflation figure. Bond returns are set at 5.25%, reflecting the fact that interest rates have risen. Equity returns are 9%. International returns are slightly higher at 9.25%. He noted that over the long-term there is no reason to believe that stocks in the international market will return more than stocks in the US. The real estate return is held at 7.6% and private equity is held at 12% net of fees.

MR. BADER commented that these changes in assumptions would appear to substantially change the portfolio if used when the asset allocation is done. For example, real estate would be much higher. He did not understand why the optimizer is resulting in such a difference when the assumptions were not changed significantly. MR. O'LEARY stated that this underscores the weaknesses of the whole process; the finer the slice, the less reasonable the outcome.

DR. JENNINGS stated the difference between broad domestic equity and domestic fixed income assumptions was wider last year. He asked if that is a result of the analysis or is the thinking that the risk premium has compressed. MR. O'LEARY replied that there is less incremental returns for any of the risk areas, other than bonds, than there was one year ago.

MR. O'LEARY reviewed a correlation coefficient matrix, noting that a negative correlation is good, but there are not many. The lower the correlation number, the greater the diversification achieved.

Private equity, real estate and absolute return are less liquid asset categories where the estimates used to drive CAI's analysis are the most subject to challenge. CAI's confidence in those estimates is lowest.

MR. O'LEARY reviewed several optimization runs that produced alternative asset mix scenarios. The first optimization scenario is based on US stocks and bonds, international stocks, and cash. MR. WILSON commented on the high allocation to domestic stocks compared to international stocks, which he presumed is based on the higher risk in international. MR.

O'LEARY explained that despite higher risk, international is providing higher return, so there is an allocation.

The second optimization scenario adds non-US bonds. That asset class takes a meaningful portion of the riskier mixes, but is only 1% in the more conservative Mix 4 and 0% in Mix 5. The third optimization scenario adds real estate; Mix 4 has an allocation of 10% in real estate. When private equity is added in the fourth optimization scenario, Mix 4 has 8%, taking real estate down to 9%, non-US fixed income from 2% to 1%, increasing bonds by 10%, and reducing US publicly traded equity to 8%. The ARMB's target allocation to private equity was increased to 7% last year.

MR. O'LEARY explained that absolute return is an amalgamation of strategies that when put together have the promise of providing more consistent returns at a lower level of volatility; the return is between that of stocks and bonds with a volatility level probably higher than bonds but lower than stocks. The risk estimate used in the fifth optimization scenario adding absolute return is 9%, while the observed volatility has been nearer 5%. To deal with this disparity, either the allocation to private equity is constrained in the optimizer or the more realistic assumptions are used in the modeling but the optimizer is told to optimize the rest of the portfolio and then add in the impact of the set-aside.

DR. MITCHELL noted that as asset classes such as absolute return and private equity and perhaps real estate are included, manager risk is introduced. The variability among managers is also very high.

MR. O'LEARY next reviewed the sixth optimization scenario adding TIPS. The optimizer includes large percentages of TIPS in the low risk/low return mixes. The higher return mixes have lower percentages of TIPS while private equity, absolute return, and real estate each have an allocation of about 8%.

The seventh optimization scenario adds emerging markets. The allocation in each mix is generally 2%, reducing private equity in Mix 4. The eighth optimization scenario adds high yield. Mix 4 in this scenario includes 6% high yield. The index for high yield managers was changed last year to the Constrained because of the downgrade of two auto industry bonds. CAI did not raise its high yield projection as much as the investment grade projection because spreads continue to narrow. When the ARMB first began investing in high yield two years ago CAI had a similar outcome in its analyses. The returns realized from the high yield asset class last year were nearly twice that of investment grade bonds.

MR. O'LEARY explained that the correlations for "other" investments are different than for other classes, so he used the TIPS correlations and a 7.6% real estate-like return to constrain the optimizer. The optimizer was told to only use this in a set-aside, limiting private equity to 7% and absolute return to 5%. Under the ARMB's current policy, the mix would yield an 8.11% return. The ARMB's policy compares well with the efficient frontier because the efficient frontier does not include "other" investments.

MR. O'LEARY asked for remarks and suggestions, noting that between now and the next ARMB meeting, CAI will be working with staff toward offering a specific asset allocation recommendation at the Board's April meeting.

MR. BADER noted that the real estate return appears to be that of core, but the ARMB has recently added more opportunistic funds. He asked whether the opportunistic funds should be included in the private equity area. MR. O'LEARY stated a real estate operating company is very different than core real estate, and it should have a higher return. He suggested using the basic building blocks for determining overall risk, but if there are assets that might generate higher returns, this portion of real estate and private equity could be considered in the same category.

MR. TRIVETTE commented that asset allocation is the most important function of the ARMB and he appreciated the clarity of Mr. O'Leary's presentation. MR. O'LEARY stated that, while asset allocation is the most important decision of the Board, implementation structure is of secondary importance.

COMMISSIONER GALVIN remarked that the optimization scenarios show that standard deviation steadily decreases as diversification increases. Diversification is done theoretically to lower risk, but not much seems to be gained by increasing diversification. MR. O'LEARY explained that part of the appearance of little gain is CAI's conservatism in the inputs. Comparing a portfolio with real estate and one without real estate, the one with real estate would have demonstrably lower volatility over five years because it is not observed. The same is true of private equity. After a framework is decided, CAI can input the volatility that would be observed for those types of asset classes. He underscored that in times of stress, all correlations move to 1%. COMMISSIONER GALVIN understood that when a number must be put on risk, CAI is basing that number upon its feel about the asset class. When that viewpoint is built into the model, it results in an apparent under estimation of the diversification value. The ARMB has reacted to that recognizing that it offers a minimal empirical advantage, but knowing that the actual numbers are different. MR. O'LEARY added that, using timber, farmland and real estate as an example, it is not necessary to be a timber expert to understand this asset class is sensitive to the economy, but one must also recognize that its cycle is probably different than commercial real estate and its characteristics are inherently different than farmland. It is not possible to define the differences in risk among these three areas, but there is some difference and over the long-term each will have comparable returns. Therefore, having all three is better than having just one.

DR. MITCHELL explained that one of the reasons some of the largest endowments and foundations have been pioneers in diversification movement is that entering into some of the newer asset classes results in being less efficient. So, if those endowments and foundations feel that if they can choose a private equity manager who might have extremely strong returns, but not a US equity manager who can do the same, they will be in both. COMMISSIONER GALVIN remarked that Harvard, for example, was able to reallocate its portfolio to take advantage of a timber investment in New Zealand; the ARMB has to have some level of confidence that moving into a particular asset class will provide a market differential that does not exist otherwise. The ARMB is faced with an asset allocation decision absent this. He asked that when the discussion of asset allocation occurs, there can be additional information where staff and CAI has some level of confidence in the ARMB's ability to choose among managers. MR. O'LEARY stated that CAI is willing to build in a premium in small cap equity because it is a reasonable risk.

MR. WILSON asked if Mr. O'Leary sees trends among his clients or in the world that he might share with the ARMB. MR. O'LEARY replied that there is a perception that alpha will always be positive when in fact it can be negative. There is also a tendency to under estimate costs associated with seeking alpha.

MR. WILSON added that he attended an asset allocation seminar where the material said, "We do asset allocation because we have no clue what is going to happen in the future." He noted that for 15 years after he graduated college the stock market had negative annual returns. At the end of the day, an investor's decision rests on the level of risk that is comfortable and deciding whether to diversify knowing that the last 15 years of data may not apply for the next 15 years.

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

19. Consensus Presentation

After introduction by Mr. Bader, MICHAEL LAMB, CFO, Fairbanks North Star Borough presented to the ARMB. MR. LAMB explained that he would make a less detailed presentation to the ARMB than he typically makes. He acknowledged the assistance of Ms. Millhorn, Ms. Morrison and Mr. Semmens with the presentation. He commended Ms. Millhorn and Ms. Morrison on their integrity and ethics and the transparent manner in which they worked on this.

MR. LAMB explained he was asked to make a presentation at the Alaska Municipal League (AML) to gain consensus on the PERS/TRS situation. He affirmed that this presentation is the official position of AML and its members.

MR. LAMB described the basic problem as the fact there is an unpaid bill. He questioned who is responsible for that liability. The supplemental report for PERS shows each employer their share of the single agent, multiple employer bill and their rate. In order to understand the bill, it is first necessary to understand what is occurring now within the PERS system. MR. LAMB reviewed the employee universe comprised of 73,300 active and retired members and a debt of $12.8 billion. The liability is $5.7 billion active and $7.1 billion retiree. MR. TRIVETTE asked where these figures were derived. MR. LAMB replied that they are taken from June 30, 2005 financial information. MR. TRIVETTE asked if the figures were taken from the Buck Consultants report. MS. MORRISON stated the figures are gross liabilities.

MR. LAMB explained that the active side of PERS is funded through employee accounts and employer active accounts, as well as the net investment return on assets. The retired side and active side each have a liability component and an asset component. The actuary develops the present value of future actuarial benefits to retirees, both pension and healthcare benefits. The liability for retirees is $7.1 billion. Based on time and service with different employees those approximately 20,000 employee liabilities are allocated to individual employers. This liability is based on time of service with each employer, regardless of the level of compensation to that employee by a particular employer. If the liability allocated to an employer is based on the compensation an employee received from another employer, then the liability number is not directly attributed to that employer's relationship with that employee. Because the system has to be balanced, assets are transferred to the Retirement Reserve Account (RRA). The RRA has a balance of $6.3 billion at June 30, while the liability is $7.1 billion. Using the Fairbanks North Star Borough (FNSB) as an example, if the FNSB had 1% of the liability its liability would be $71 million. Based upon that percentage, irrespective of the assets the FNSB has put into the system since it became a member, it is allocated $63 million from the RRA. The actual amount of money that any employer has put into the RRA has not been tracked over the years, but each employer can trace it. Each year since 1971 when the RRA was established, the reallocation of assets has used blended assets, so the State cannot say what has happened with the money the FNSB has put into the RRA.

On the active side the employee and employer accounts totaled $1.5 billion at June 30 and the total liability is $4.2 billion.

COMMISSIONER KREITZER felt it was fairer to say that the actual dollar amount of employer contributions to the RRA cannot be proven. MR. LAMB agreed that this was a more accurate statement. He reiterated that the DOA has been absolutely forthright and transparent. He was simply explaining that when an employer receives a bill, it is not substantiated.

CHAIR SCHUBERT asked whether anyone has looked at the fact that an employee's retirement pay is based on the highest compensation received for three years of service, so they could theoretically have a much higher paying job for three years and worked many years at a lower paying job. She asked if the impact of that on the liability has been examined. MS. MILLHORN replied that this has not yet been analyzed. Beyond the identification of the elected official population, individuals' actual salaries have not been identified.

MR. LAMB continued his presentation with a review of a timeline of significant events over the history of the PERS system since 1961. He explained that one employer's liabilities are affected by another employer's actions if they have each had the same employee. From 1961 through 1971 it appears that the system was operated as a single agent, multiple employer system. The employer accounts paid the pension, etc. The RRA was established in 1971 and it is the first time there was blending of assets. He remarked that what has occurred throughout the years the system has been in place is what was needed to administer the program. He felt that blending of assets might not have been well advised. In 1972 the State absorbed a shortfall in the RRA. If that is the case, employers who had not paid enough into the RRA received assistance from the State while other employers did not. This leads to the question whether one employer was advantaged and the other not advantaged. From 1971 through 1974 funding was transferred from the active side to the RRA in order to bring assets and liabilities into balance. In 1994 there was a memo that essentially said it is not fair to the employers from whom liability payments are taken during the year because once a year the shortage is allocated evenly among individual employers and those employers would be double-billed. A decision was made to allocate the liability balance to all employers. If only one employee retired during the year and that employee worked for three employers, their individual liabilities would be slightly higher than everyone else's. Because the assets are reallocated to the employers based upon their percentage of the liability, an employer that had a bigger liability got more of the assets although they did not transfer any over. He stated that tracing assets through the system back to a specific employer is made even more difficult.

MS. HARBO asked how employers that did not pay were assisted in 1971. MR. LAMB replied that it would have to be assumed that if all of the employers were fully funded at the time, there would be no reason to put all of the money into a single account and then pay benefits. He concluded, therefore, that something drove commingling of assets. Therefore, if an employer did not have money to pay, they received help. MS. HARBO asked from whom that employer would have gotten help. MR. LAMB replied that the other members who were putting funds into the pool helped them. MS. HARBO understood Mr. Lamb to say that some employers were overpaying, not that there was a legislative appropriation that helped employers who were unable to pay. MR. LAMB stated that in 1971 the RRA was established and he believed that in 1972 there was a legislative action to make up the shortfall. In the end, the presumption is that some employer did not have enough money to pay the benefit accrued to them. MS. MORRISON stated she discussed this with Mr. Lamb at great length. There has been no documentation to explain why the RRA was created. She thought it was created to bring about ease administratively because it is easier to pay benefits out of one pool than from 160 employers. She had no reason to believe that any employer could not fund their retirees. Currently there are no employers with negative assets in the plan.

CHAIR SCHUBERT asked if an employer could have assets in the plan but never have made a contribution to the plan. MS. MORRISON did not believe this was possible. MR. SEMMENS asked whether an employer could have allocated assets in the RRA when in fact they have never contributed assets to the RRA. He was confident that the answer is "yes" because the Board has seen an example. MS. MORRISON stated the example she provided to the ARMB in September 2006 showed the tremendous asset gain of an employer at the time they had their first retiree. MR. SEMMENS explained the point is that these assets are not tied to an individual employer.

MR. LAMB stated that the end result of actions taken decades ago conflicts with statute for a single agent, multiple employer system.

MR. LAMB reviewed an example of Bering Straits' being assigned assets in the RRA without contribution at the time that employees first began retiring from that employer. MR. SEMMENS understood that employer also had a substantial benefit in the reduction of their employer contribution rate.

MR. LAMB reviewed the example of City of Kenai in FY05. The City of Kenai was required to contribute $3.8 million into the system in that year when one employee retired with a $1 million net present value actual liability. He posed the question whether the City of Kenai is paying liabilities incurred by others.

MR. LAMB reviewed a list of points indicating that the State had and has the primary role in the current circumstance. He explained that "State" refers to the Legislature, PERS Administrator, PERS Board, ASPIB and ARMB, collectively. He reviewed the following points: employer liabilities have been affected by other employer actions; since 1971 assets have been blended and reallocated year after year and, as a result, the State cannot say what any individual employer's asset or liability balance is; the normal rate since 1977 has been a blended rate; PERS is a consolidated system; and the historical recreation of records since 1971 is not possible, so it is not possible to identify who has or has not been advantaged/disadvantaged. The components of a shared solution include: amending State statutes to reflect that PERS is a consolidated system; having one normal cost rate for all member employers; that 85% of the unfunded obligation should go on the State's books and be paid by the State and that the other 15% belongs to all PERS members; that the unfunded liability should be a set rate for everyone; the TRS obligation should be treated the same way; and methods to reduce the future carrying costs of the unfunded obligations should be sought and used.

MR. LAMB stated that an 85/15 cost sharing is proposed because it is not possible to recreate historical records and, accordingly, it is not possible for the State to send a properly and legally allocated bill to each participant. Therefore, a method must be devised to fund the unfunded obligation in a logical and rational manner. An 85/15 split is sensible for the FNSB. For 22 years the FNSB had a 4.17% total average employer PERS rate and an 85/15 for FY08 would be a 438% increase over that 22-year average. The FY08 ARMB approved rate of 29.98% is a 719% increase of the 4.17%. With a system wide average rate of 39.76%, the increase would be 953% of the 4.17% and a FY09 PERS rate of 46.64% would be a 1,118% increase of 4.17%.

MR. LAMB read a draft memorandum from him to the FNSB mayor discussing the proposed 85/15 scenario, stating that the FNSB is in the middle of building a FY08 recommended budget that requires final decisions in less than four weeks and that he is unaware of any legislation attempting to deal with the significant and material issue that the PERS system is not a multiple employer, single agent system and has not been administered in accordance with state statute and has reallocated different employer PERS assets to other member employers. The memorandum quotes FNSB Code of Ordinance 3.01.110, which states that "borough directors, other borough employees designated by the mayor and the superintendent of schools shall certify to the controller requisitions and requests for payment covering expenditures against their respective appropriations. Such certification will attest that the requisition or request is legal and proper and is made for an amount not in excess of the sum made available for the purpose named therein" and that "the chief financial officer shall enter such requisitions or requests after being certified as aforesaid on the books of the accounts of the borough." The memorandum continues that, in accordance with the provisions of the code and undisputed knowledge of how the FNSB approves assets, liabilities, and unfunded balance, and therefore the past service cost rate is calculated by and for the state, the certification that the borough's past service cost rate of 15.5% as has been published for FY08 by the State cannot be made. He concludes that it is his opinion that any billing from the state relating to any borough PERS unfunded obligations cannot be legally paid.

MR. LAMB stated that if the matter is resolved, the memorandum would not be completed or submitted. The Fairbanks mayor and the FNSB are willing to accept a 438% increase in the average rate they have paid over 22 years. While this is a large variation, it can be managed. Using the 85/15 scenario, the rate will be higher next year and the FNSB can live with that. The 719% increase cannot and will not be paid. More than a 438% increase exceeds what a participant using logic and rational thought could have expected, and it clearly does not meet any standard of predictability, stability or affordability.

MR. LAMB suggested that if a conclusion cannot be reached where all parties share in a solution, there would be consequences. He asked that the ARMB support a shared solution by amending State statutes to reflect that PERS is a consolidated system; there should be one normal cost rate to all member employers; that 85% of the unfunded obligation should go on the State's books and be paid by the State and the other 15% belongs to all PERS members; that the unfunded liability should be a set rate for everyone; that the TRS obligation should be treated the same way; and that methods to reduce the future carrying costs of the unfunded obligations should be sought and used. He asked that the ARMB look at the material he had presented, the consequences of not supporting the 85/15 solution proposal, and give consideration to supporting the 85/15 solution.

CHAIR SCHUBERT noted there is a resolution associated with Mr. Lamb's presentation.

COMMISSIONER KREITZER moved Resolution 2007-04 Relating to Cost-sharing multiple-employer plan for the Public Employees Retirement System's Defined Benefit Plan. She explained that she does not believe it is appropriate that the ARMB take a position on whether the State's portion of the unfunded liability is 85% or 15%, but it is appropriate for the ARMB to support a cost share solution for PERS; that is what this resolution does. MS. HARBO seconded.

MR. TRIVETTE noted that the resolution is lengthy. The ARMB does not have all the facts and he hesitated to adopt a resolution that includes language that the ARMB does not know is substantiated. He moved to amend the ninth "whereas" so that it states, "WHEREAS, commentators on the foregoing problem have advocated that the PERS Defined Benefit Plan utilize a cost sharing multiple-employer arrangement similar to that utilized for the Teachers' Retirement System's Defined Liability Plans (TRS)." MS. HARBO seconded.

MR. SEMMENS believed that much of Mr. Lamb's presentation speaks to, and it has been concurred with the Administration, the language Mr. Trivette proposes be deleted, "…and that factors favoring a change to such a process include the difficulty in ascertaining the proper asset balances and rates assignable to each employer and the attendant disruption and cost of definitely resolving the issues through a dispute process," is factual. COMMISSIONER KREITZER asked for Mr. Barnhill's input. MR. BARNHILL thought this paragraph was a representation of what commentators are saying, not what the ARMB is saying. He did not object to either striking the language or allowing it to remain.

MS. HARBO believed the language should be deleted. She wished these resolutions had been received with the original packet so the ARMB had more time to review the language. COMMISSIONER KREITZER explained that the delay in relaying the resolution is a function of change in Administration.

By roll call vote, the motion to amend failed with Trivette and Harbo in favor and Kreitzer, Semmens, Williams, Galvin and Schubert dissenting.

MR. TRIVETTE asked if there would be any negative ramifications from item 1 on page 2 that "The Board supports implementation of a cost-sharing multiple-employer arrangement for the PERS Defined Benefit Plan analogous to the arrangement used for TRS." MR. BARNHILL had no concern with implementing a cost-sharing arrangement. The caveat is that there are certain employers whose contribution rates will rise and others whose contribution rates will go down. There is no legal problem with going to a cost-sharing solution. COMMISSIONER KREITZER explained this resolution was an attempt to include the ARMB in this decision process. The State will next draft cost-share legislation. She stated she would ensure that the ARMB has an opportunity to see that legislation going forward and express any concerns.

MR. SEMMENS appreciated item 2 that "The Board supports consideration of a settled upon allocation of liabilities between the State of Alaska and other participating employers and recognizes that the proper entity to allocate additional liabilities is the Alaska Legislature," and agreed that ultimately the Legislature makes the final decision. He stated his seat on the ARMB reflects finance officers throughout the state. He recognized the position that finance officers are in around the state. After hearing the FNSB finance director say the bill will not be paid, he thought the ARMB may have interest in making a recommendation to the Legislature that the agreed upon allocation is such that municipalities can continue to pay their contributions to the system. If the municipalities do not pay their contributions to the systems, they will be negatively affected. He noted that, from his perspective, the State has a better chance of paying the liability.

MR. TRIVETTE agreed that this issue must be resolved and that the State's share is a major burden.

By roll call vote, the motion passed unanimously.

LUNCH BREAK 12:15 p.m. to 1:30 p.m.

20. Plan Administration Taxation Issues

MR. WILLIAMS moved to conduct an Executive Session for the purpose of receiving attorney-client privileged material. MR. SEMMENS seconded.

There being no objection, the motion passed unanimously.

EXECUTIVE SESSION 1:32 p.m. to 3:15 p.m.

BREAK 3:15 p.m. to 3:23 p.m.

21. Resolution 2007-02: Ratification of Rules

CHARLENE MORRISON stated Division of Retirement and Benefits (DR&B) staff reviewed statutes and board action to date after the last ARMB meeting and found AS 37.10.225 had been overlooked. The statute indicates that the ARMB is to establish the rules by which the Defined Contribution Retirement Plan, the Supplemental Benefit Annuity Plan, and the Defined

Contribution Plan participants can direct their investments. Staff asked the ARMB to consider the resolution to ratify the default services for the plans.

MS. MORRISON explained that the Deferred Compensation is a 457 plan and has no default options. Members who opt to participate in this plan are required to select their investment options at the time they enter the plan. Beginning in October 2006 these members were allowed to opt into the managed account plan. For the Supplemental Benefit Annuity Plan, the default was the Alaska Balanced Trust until June 15, 2001 when it was changed to the Long-Term Balanced Trust. In October 2006, those members were allowed to opt into the managed account service, if they so chose. Effective January 1, 2007, new members enrolling in this plan were being automatically enrolled into the managed account system. They could opt out and later opt in by filling out a form. New members in the Defined Contribution retirement plan were automatically enrolled in managed accounts from the inception of the plan and from their enrollment in the plan. They also can opt out and choose later to opt in. Managed accounts are also referred to as reality investing.

MR. WILLIAMS asked with respect to the contractual obligations, what are the general terms of the managed accounts arrangement, that is, how long is the arrangement in place and what is the cost. MS. MORRISON replied that the cost is 50 bp up to a certain amount and then it ladders down. The contract with Great West is either three or five years. MR. WILLIAMS saw that the briefing discusses what the DR&B considered the best approach for educating members and he understood the DR&B determined that the best approach is putting the cost on members for their education rather than issuing an RFP for a company to provide investor education. MS. MORRISON stated that either way, the member pays for the cost. If education were provided in another manner, perhaps a General Fund appropriation would have been needed. The plans do not have a mechanism to cover such a cost on their own. MR. WILLIAMS asked if it would have been more costly to the member to receive advice in some other format versus the 50 bp per year charged to their account. MS. MILLHORN stated there was discussion in the past that centered around bundled versus unbundled services. She wanted the commissioner to look at the costs associated with that. There is a provision in the contract with Great West that the State can go out with an RFP before the end of the Great West contract period. MR. WILLIAMS stated he is sensitive to bundled versus unbundled services and the drag it has on a participant's investments over time. His concern was the cost of a one-time consultation amortized over time versus a 50 bp annual fee. MS. MILLHORN stated that the investment advice component is available at a cost of $25 a year. Participants can transfer to the managed account, which rebalances automatically.

COMMISSIONER GALVIN raised concerns that the charge of 50 bp will be criticized when participants could have had their money in an account that is managed without that cost. He asked what is the background of the RFP, noting that he has heard some concern from other professionals in the industry about their knowledge of this RFP. MS. MILLHORN stated she has not heard specific concerns with other parties not being aware of the RFP. There was discussion with the ARMB and the DR&B proposed being given an opportunity to construct the RFP with both a bundled and an unbundled approach, look at the market drivers in the RFP process, and then decide what is best for participants and the DR&B. The ARMB Trustees were not convinced to allow the DR&B to do the RFP in that fashion. One of the advisors to the plan indicated that, given the size of the plan, an unbundled approach is typical. There was an informal proposal that the basis points to provide all of the services, including recordkeeping, financial advice, education, and a couple of investment options would have reduced the cost; there was an indication that the RFP could have had a bundled approach. COMMISSIONER GALVIN asked if the RFP was widely distributed. MS. MILLHORN replied that the process involved the procurement officer, who put the notice online, and letters were sent to the various entities that were identified as potential bidders. Not many proposals were received. She recused herself from sitting on the PEC because she had been presented with the informal proposal that suggested to her the basis points could have been reduced. MS. MORRISON believed three proposals were evaluated. COMMISSIONER GALVIN asked for comment from Mr. Bader and the advisors about their sense of the proposed costs. DR. JENNINGS stated he works with a smaller pension that is paying 40 bp a year. He took exception to the statement in the information that private sector fees run 150 to 300 bp because that is a fee for someone investing their own funds with a brokerage firm. He stated that in general education programs are funded by the sponsor, but there is some academic and practitioner evidence that it does not work; people do not attend the sessions and/or do not implement the education from those sessions. He remarked that life cycle funds are a rebalanced, zero cost option and many plans are looking at them as a way to get professional investment advice, widely distributed, relatively cheaply. He stated that the Air Force organization with which he works has a 40 bp fee associated with that and it is an opt in rather than a default arrangement.

DR. MITCHELL stated the anecdotal evidence he has agrees with what Dr. Jennings said.

MR. BADER believed the intent of the RFP was to address the fact that many people do not select options. In those plans the general default is cash so the person who does not have a selection in place would have cash. This is why the ARMB selected the Long-Term Balanced Fund as the default. He did not think there was much discussion at the ARMB meeting about SBS being changed. The discussion about the RFP related to the new Defined Contribution Plan. He recalled there was discussion that a 50 bp per year fee over the life of a person's career is expensive.

MR. O'LEARY stated this area has experienced rapid change over the last 12 to 18 months one of which is the hedge protection act that helped set state-of-the-art practice in the private sector. While the regulations are not finalized, CAI has observed significant movement toward the use of target maturity funds as the default option in private sector defined contribution plans. Mr. Bader is correct that prior to this there was a tendency in the private sector to have the default option be less risky; there was fear on the sponsor's part of their vulnerability should a balanced option not work. Participants were not managing their assets, which gave rise to the perceived need to educate people and, if they could not be educated, to relieve them of that responsibility. In the private sector, the balanced option is becoming the default option. He stated that 40 bp for a managed account situation is not trivial, it is significant, but for people who need it, this may be the best solution; hopefully not many would need it.

MR. SEMMENS stated the empirical evidence is that once people are defaulted, that is where they stay. He asked if there is a contractual obligation to default people into the managed account plan. MS. MORRISON believed the contract says the default is managed accounts.

There were extensive negotiations with Great West, including a 60-day trial period for members to be able to use the managed account without cost and if they opted out in that period, they were not charged. They could choose the $25 a year advice or the free level. The DR&B wanted to be sure that those who chose to ignore the educational material were protected by a professional investing their assets.

COMMISSIONER GALVIN asked if the choice to go into the default is available under the new program. MS. MORRISON thought there might be a contractual issue, but otherwise the options exist. COMMISSIONER GALVIN understood from the background materials that it was discovered the ARMB has the responsibility to define the options and make them available. He asked if the fact the DOA contracted, perhaps outside of that authority, limits the ability of the ARMB to act differently. MR. BARNHILL believed there is a clause that the contract can be terminated at will if it is in the public interest. If the ARMB feels that is the case, there may be that option, but he would prefer to review the contract before stating this definitively.

MR. TRIVETTE recalled that there was a discussion about whether or not the ARMB wished to overturn the previous board's decision to have a number of options and the ARMB said it did not. He recalled that the ARMB said that the Long-Term Balanced Fund should be the default option. He asked what type of payment consequences could exist by canceling the contract. MS. MORRISON did not recall the specifics related to invoking cancellation.

COMMISSIONER GALVIN asked if participant money is currently going into managed funds. MS. MORRISON replied that for new participants in the SBS and Defined Contribution Retirement Plan, this is the case. Their funds go into managed accounts and are allocated per the allocation by the investment professionals.

COMMISSIONER GALVIN requested a two minute at-ease, following which he moved to adopt a Resolution 2007-02 Relating to Plan Member Investment Rules to delete the fourth "whereas" clause and change the final clause to state "NOW THEREFORE, BE IT RESOLVED BY THE ALASKA RETIREMENT MANAGEMENT BOARD, that the default service for new members of the Supplemental Annuity Plan beginning January 1, 2007 and for all members of the PERS and TRS Defined Contribution Plans from inception be the Long-Term Balanced Fund." MS. HARBO seconded.

COMMISSIONER GALVIN explained that this resolution would allow that for members of the Supplemental Annuity Plan beginning January 1, 2007 and for all members of the PERS and TRS Defined Contribution Plans from inception the default plan would be the Long-Term Balanced Plan.

MR. JOHNSON suggested that the motion direct staff or counsel to take all steps necessary to refine the language as required. *The motion was so amended.*

MR. SEMMENS understood that a participant that came into the system July 1 is in the managed account and certain allocations have been made with their money. He asked if those funds would be removed and transferred to the Long-Term Balanced Fund, or would future allocations be put in the Long-Term Balanced Fund or is Mr. Johnson going to figure it out administratively.

COMMISSIONER GALVIN felt the question would be the communication needed in order to identify what is in those individuals' interests.

MR. BADER had some discomfort because all of the participants have been notified that the plan is structured a certain way and there could perhaps be legal consequences if there is no notice to the participants that the plan is being changed. In the past when an option is added or deleted there has been notification to participants allowing them a period of time to make the change. MR. BARNHILL felt this was an excellent observation.

MR. WILLIAMS asked the DR&B if this motion should be acted upon at this meeting or could it wait until April. MS. MILLHORN saw no harm in postponing this matter to the April ARMB meeting. MR. WILLIAMS felt this would allow staff and counsel time to review the potential consequences of the resolution.

MR. WILLIAMS <u>moved to table the motion.</u> COMMISSIONER KREITZER <u>seconded</u>.

By roll call vote, the motion passed with Williams, Semmens, Kreitzer, and Schubert in favor and Trivette, Harbo, and Galvin dissenting.

COMMISSIONER GALVIN wished to ensure that the ARMB has clearly requested from staff that it receive a full implementation program at its April meeting to move the default to the Long-Term Balanced Fund.

22. Division of Retirement & Benefits Report

A. Appropriation re Contribution Rates

MS. MILLHORN reviewed information distributed by Ms. Hall addressing the Retiree Dependent Eligibility Verification Project that removed 2,181 dependents at a savings of $10.7 million, and the Active Dependent Positive Open Enrollment that removed 1,243 dependents for a savings of $3.77 million annually. The information regarding Claims Administration and Pharmacy Benefit Management Contract respects the change going from Aetna to Premera Blue Cross. The cost savings in third party administration for the July-August two-month period in 2006 compared to 2005 is approximately $815,000. Based on that projection, an overall cost savings of $4.9 million is projected.

The packet includes an analysis of employees who have returned, those with indebtedness, the paid on indebt amount, and those terminated in the PERS and TRS Defined Benefit Plans, the PERS and TRS Defined Contribution Plans, and noting that three employers participate in the conversion option. One TRS member has recently converted to the Defined Contribution Retirement Plan.

B. Director's Report – None

23. **Action Item**

CHAIR SCHUBERT noted that Resolution 2007-05 had been distributed to the trustees earlier for review. MR. TRIVETTE indicated he had reviewed this information with Mr. Teal, who offered changes. He moved the adoption of Resolution 2007-05 Relating to the Teachers Retirement System Defined Benefit Plan Contribution, amending item 1 to state "The Board supports appropriations to pay funds directly from the treasury of the State of Alaska into the TRS Defined Benefit Plan for identified portions of the obligations imposed as TRS Defined Benefit Plan employer contributions," and amending item 2 to state "Because the TRS Defined Benefit Plan employer contribution obligations imposed by the Board would be offset by appropriations paid directly into the TRS Defined Benefit Plan, the rate therefore assigned to individual employers under the TRS Defined Benefit Plan will be offset in the amount reflecting those appropriations." COMMISSIONER GALVIN seconded.

MS. HARBO asked for explanation of item 3, "The Board encourages any and all other measures, including legislation amending the TRS Defined Benefit Plan…" MR. JOHNSON explained that his intent in drafting this language was to recognize that it might be necessary to develop legislation to provide for the offset issue. Legislation may be necessary to describe that employer contribution rates may be reduced. It may be that the ARMB wants to take further action to reduce it by a specific amount. The intent of the resolution language was that the ARMB would support such as other measures, including legislation, to accomplish the purposes of this resolution.

By roll call vote, the motion passed unanimously.

VIII. UNFINISHED BUSINESS

1. Disclosure Report

JUDY HALL reported that a disclosure report is contained in Trustees' packets.

2. Legal Report – Litigation Appropriation, Resolution 2007-06

MIKE BARNHILL indicated he had distributed a resolution yesterday for the Board's review. CHAIR SCHUBERT noted that this was discussed in past meetings. MR. BARNHILL stated the Attorney General has investigated the work done by the system's prior actuary and based on that investigation an appropriation of $12 million is being sought to pay to complete the investigation and potentially begin litigation. This resolution is intended to seek the ARMB's support for that appropriation and potential litigation.

MR. TRIVETTE moved adoption of Resolution 2007-06 Relating to Actuary Litigation. MS. HARBO seconded.

By roll call vote, the motion passed unanimously.

IX. NEW BUSINESS – None

X. OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD

MR. BADER reviewed items of legislation that impact retirement issues. HB 12 was introduced by Representative Hawker and provides a mechanism to reduce the unfunded liability that TRS, employers and the State's share of PERS unfunded liability by an amortization period not to exceed seven years. HB 13, also by Representative Hawker, permits the Alaska Municipal Bond Bank or a subsidiary to assist state and municipal governments by issuing bonds, notes, commercial paper and other financial instruments. It permits the issuance of bonds or other obligations to enable governmental employers to pre-pay all or a portion of their unfunded liability to the retirement system. HB 48 by Representative Seaton and Representative Kelly gives authorization to the ARMB to purchase investment tax credits, which would be generated under the recently enacted PPT law. This would allow the ARMB to purchase these credits for 92% of their value. The concept is that if the credit can be bought for $.92 and sold to the Treasury for $1.00, the return is 8.6% or an annualized rate of return of 220%. He believed there could be a situation where a tax credit is available but no income to offset that credit, so the credit is sold. This would ensure there is a market for the credits. HB 97 and companion legislation SB 52 introduced by Governor Palin would make direct appropriations for school districts of $36,981,562 for PERS and $170,450,921 for TRS. HB 107 and SB 61, introduced at the request of the Governor, relate to potential litigation.

CHAIR SCHUBERT asked that, if there is any legislation that concerns the system, the ARMB be informed. COMMISSIONER GALVIN asked that State employees who will be testifying at hearings inform Ms. Hall so that ARMB Trustees could be informed.

COMMISSIONER KREITZER stated the cost-share legislation discussed during this meeting would be distributed to Ms. Hall for distribution.

XI. PUBLIC/MEMBER COMMENTS – None

XII. INVESTMENT ADVISORY COUNCIL COMMENTS

DR. MITCHELL stated that as an investment advisor he has been concerned for the last year that, with the additional responsibilities the ARMB has been given, investment management might be given too little emphasis. While his position as an IAC member requires that he maintain this concern, today that concern is at a lower level. Of the 22 agenda items for this meeting, 11 were principally investment related and 11 were principally administrative, which seems like a reasonable balance. He congratulated the Board and staff for fitting so many important matters into a two-day meeting. As the fund becomes more complex and as asset classes become less mainstream and individual managers and gatekeepers and consultants become more important, he will urge the ARMB to not ignore the investment part of the meeting. With regard to the manager presentations at this meeting, he found that six of the seven were encouraging and that RCM warrants continued attention. Each of the other six has the potential to add value and inspire confidence. He remarked that Mr. O'Leary's presentation of CAI's capital market assumptions was clear and professional, but it leads to more questions for the upcoming asset allocation. He noted that the investment staff should be recognized for their professional and forward-looking stewardship of the funds for which they are responsible.

Speaking to Mr. O'Leary's presentation on CAI's capital market assumptions, DR. JENNINGS stated that anyone who attempts to build and explain a 13-asset class correlation matrix and get good output deserves admiration. He felt the ARMB should be grateful for a consultant who can explain that process as clearly as Mr. O'Leary. He believed with respect to equity risk premium, that is, the difference between expected return on stocks and Treasury bonds, that lower equity risk premium going forward is a correct assumption. Higher recent returns and higher overall risk tolerance in the market means there will be lower risk premiums in all categories, particularly in the very liquid public markets. He felt CAI's 2.75% inflation assumption is good. He felt that the risk premium and inflation estimates are most important in the discussions the ARMB will have regarding asset allocation in April. He remarked that a question and one of the exhibits referenced the idea of salary spiking. He stated there are limitations in the pension legislation in Colorado last year to limit salary increases to 8%.

XIII. TRUSTEE COMMENTS

MR. SEMMENS voiced appreciation for the contributions from the two new ARMB members and their clear interest in getting the problem solved.

MS. HARBO thanked Mr. O'Leary for his intriguing presentation. She thanked staff of the DOA and DOR for their work.

MR. TRIVETTE welcomed the new ARMB Trustees and expressed appreciation for their willingness to work with the ARMB. He stated that some ARMB members recently attended a real estate conference that he found excellent. He expressed concern that it would be difficult for the ARMB to get its work done in five meetings this year. He recalled last year's meeting with the actuaries and suggested that there should be sufficient time allocated to that topic this year.

XIV. FUTURE AGENDA ITEMS

XV. ADJOURNMENT

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

There being no objection, the motion PASSED unanimously.

THERE BEING NO FURTHER BUSINESS TO COME BEFORE THE BOARD, THE ARMB MEETING ADJOURNED AT 4:25 p.m. ON February 9, 2007.

Chairman of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary

Gayle W. Harbo

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