State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location of Meeting
Kenai-Denali Room, Anchorage Marriott Hotel
820 W. 7th Avenue, Anchorage, Alaska

MINUTES OF
June 13-14, 2007

Wednesday, June 13, 2007

CALL TO ORDER

Vice Chair SAM TRIVETTE called the meeting of the Alaska Retirement Management Board (ARMB) to order at 9:00 a.m.

ROLL CALL

Seven ARMB trustees were present at roll call to form a quorum.

ARMB Board Members Present
Gail Schubert, *Chair* (arrived 9:07 a.m.)
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Commissioner Annette Kreitzer
Martin Pihl
Tom Richards
Larry Semmens
Mike Williams

ARMB Board Member Absent
Commissioner Patrick Galvin

Investment Advisory Council Members Present
Dr. William Jennings
Dr. Jerrold Mitchell
George Wilson

Consultants Present

Robert Johnson, outside legal counsel
Mike Barnhill, Alaska Department of Law legal counsel
Michael O'Leary, Callan Associates, Inc.

Department of Revenue Staff Present
Brian Andrews, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Julie Pierce, State Comptroller
Judy Hall, Board Liaison

Department of Administration Staff Present
Rachael Petro, Deputy Commissioner
Patrick Shier, Director, Division of Retirement and Benefits
Kathy Lea, Retirement and Benefits Manager
Freda Miller, Retirement and Benefits Manager

Invited Participants and Others Present
David Slishinsky and Chris Hulla, Buck Consultants, Inc.
Leslie Thompson, Gabriel Roeder Smith & Company
Jack Kreinheder, SOA Office of Management & Budget
Chad Stiteler, Anchorage School District
David Teal, Legislative Finance
Pete Ecklund, Representative Meyer's Office
Eric Tollefsen, Anchorage School District
Alden Thern, Anchorage School District
Michelle Yerkes, Municipality of Anchorage

PUBLIC MEETING NOTICE

Judy Hall confirmed that proper public notice of this meeting had been published.

APPROVAL OF JUNE 13, 2007 AGENDA

GAYLE HARBO moved to approve the agenda for June 13. LARRY SEMMENS seconded.

Chief Investment Officer GARY BADER stated that it would be convenient for the actuarial firm if the Board were able to conclude all the actuary work in one day. He requested that Item #7 on the June 14 agenda, resolutions for setting the FY08 contribution rates, be added to the end of today's agenda. He said the Board might have questions for the actuary related to the proposed actions. He said he consulted with Mr. Barnhill, who said he did not think there was a problem with moving this agenda item forward.

COMMISSIONER KREITZER said she appreciated the Board having the ability to question the actuary before taking action on the resolutions, but she was uncomfortable with taking final action on it today. She proposed taking final action tomorrow, when the public notice indicated.

MR. SEMMENS indicated that he planned to bring forward a substitute resolution that he was asking staff to copy and distribute before lunch today.

COMMISSIONER KREITZER moved that a discussion of resolutions 2007-20 and 2007-21 on the June 14 agenda be held later today. MR. SEMMENS seconded.

Both the amendment and the main motion passed unanimously, meaning the agenda was approved with one change.

CHAIR SCHUBERT arrived at this point and assumed the duties of chair. She said the discussion on the two resolutions would take place at the end of the Question and Answer section this afternoon.

BOARD WORK SESSION - ACTUARIAL REVIEW:

CERTIFICATION OF 2006 VALUATION

LESLIE THOMPSON, Consulting Actuary with Gabriel Roeder Smith & Company (GRS), listed her credentials and stated that she was hired to do the actuarial review of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the National Guard and Naval and Militia Retirement System (NGNMRS).

MS. THOMPSON said she conducted the review of the three actuarial valuations that were prepared by Buck Consultants, the state's actuary, and did not find anything unreasonable or have any concerns at all about the valuation results as presented. GRS is going back and forth with Buck on a few very technical issues, but these are just different applications of techniques.

MS. THOMPSON stated that GRS validated the liabilities by looking at the benefits as projected for each plan and for each decrement, and they looked at it for each age. In some cases GRS was not able to get all that data. So GRS will be recommending for next year that they get the actual benefit stream so they can calculate the liabilities using the decrement tables. However, when GRS got just the total liability for a person they were able to match that, so they remain of the position that Buck's findings and the valuations are completely reasonable.

MS. THOMPSON said that last year GRS had recommended that the valuations on the health care side take into account underlying claim costs on an individual basis, rather than the aggregate basis that Aetna provided. She said it looks like Buck is continuing to move in that direction. GRS heartily recommends that they continue to get to the underlying claim costs so the retirement systems' valuations are truly data-driven based on the underlying behavior of all the plan participants.

MS. THOMPSON stated that she saw some changing assumptions in the health care portion of the plan, and nothing looked unreasonable. However, GRS recommends that more explanation be given for why changes are made. In closing, she reiterated that GRS certified to the valuation results based upon the level of audit that they provided.

COMMISSIONER KREITZER said she thought the reason for the second actuarial valuation was to replicate the results of the Buck Consultants' valuation. If that was not the case, she wondered about the purpose of the second valuation.

MR. BADER explained that the statute requires that no actuarial material be presented to the Board until it has been reviewed by a second actuary. The position has been that "review" means an opinion as to whether or not the methodologies were done correctly, but not a full replication.

The Board's outside legal counsel, ROB JOHNSON, added that the statute uses the verbs "review" and "review and certify." The word "review" has not been interpreted as replication.

COMMISSIONER KREITZER said it might be a misunderstanding on her part, but she was expecting a replication of the actuarial valuations from the second actuary because of issues with the state's previous actuary.

MR. BADER explained that there is a reference later in the statute that an audit be made every five years. Staff would be bringing a request for proposal to the Board at some point to actually hire another actuary to do what he believed would be full replication, in order to get the comfort that the Legislature intended. He said he did not think the Legislature was asking for a full replication every year.

MR. TRIVETTE asked when GRS's final report would be available. MS. THOMPSON replied that GRS has received comments back from Buck and will be digesting those and then finalizing the report in about two weeks.

2006 VALUATION REPORT REVIEW - PERS/TRS/MGNMRS

DAVID SLISHINSKY and CHRIS HULLA of Buck Consultants attended the meeting to present the June 30, 2006 actuarial valuation results for the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), and the National Guard and Naval Militia Retirement System (NGNMRS). *[There were numerous slides and backup documents to support this presentation, which are all on file at the ARMB office.]*

MR. SLISHINSKY first spent some time reviewing Buck's actuarial process for the benefit of new Board members. There are four traditional State of Alaska defined benefit pension plans: PERS, TRS, the Judicial Retirement System, and the NGNMRS. There is also a defined contribution plan for PERS and TRS that became effective July 1, 2006 for people hired on or after that date. There is a post-employment health care plan that covers all members in the defined benefit and defined contribution plans. Actuarial valuations are performed annually for PERS and TRS. The Judicial Retirement System and the NGNMRS actuarial valuations are performed biannually with a roll-forward valuation in-between.

MR. SLISHINSKY stated that, per information supplied to Buck, the ARM Board has responsibility for PERS, TRS and NGNMRS, and the Commissioner of Administration is responsible for the Judicial Retirement System. He said that question was raised last week in a discussion with Pat Shier, the Director of the Division of Retirement and Benefits. Some analysis of SB 141 indicates that the Judicial Retirement System also falls under the ARM Board, so Buck will be providing those valuation results to the Board at a later date.

MR. SLISHINSKY explained that Buck conducts an analysis that quantifies the benefit obligation, also referred to as the present value of future benefits, or the actuarial liability. The process entails collecting information so that Buck can project forward what all the benefit payments are expected to be from both the pension and the health care plans. This process determines the actuarial soundness of the current contribution rate, or will determine the actual contribution rate that is necessary to actuarially fund the benefits. Buck also measures the funding status to let the Board know how well each plan is funded as of the valuation date. It serves as an early warning system for potential future funding problems. When there is an unfunded liability, it doesn't mean that the retirement plan is in dire straits or that there isn't enough money to pay the benefits currently. It just means that unless there is some recognition of payment for that unfunded liability, future funding problems will develop.

MR. SLISHINSKY listed the information that Buck collects. He said the expected benefit payments over future years are calculated and then discounted back to the valuation date at an assumed investment return rate. These calculations are performed on each individual member — all actives, retirees, deferred vesteds, and beneficiaries — to reach a value for each member. Those values are summed and presented to the Board in a summary.

MR. PIHL inquired what discount rate Buck used. MR. SLISHINSKY said 8.25%. He added that if the Fund earned 8.25% from one year to the next, the accumulation of assets would then match the value of the benefits that were accruing.

MR. SLISHINSKY stated that actuarial assumptions for demographics, economics, and health care are used in an attempt to predict future experience. The assumptions are studied regularly through an experience analysis, one of which Buck performed for the State last year. Inflation should be consistently applied to salary increases/cost-of-living adjustments (COLAs), investment returns, and health care trends. The actuary recommends the actuarial assumptions to the ARM Board, and the Board approved the most recent assumptions at the October 2006 meeting. Actuarial mathematics is a science, but its application in the real world is an art, so setting the assumptions is a blend of the two. There is some noise in the data, and the actuary uses methods to smooth that out. It does not mean that there is one right answer and all the other answers are wrong; generally, there is a range of acceptable answers.

MR. SEMMENS asked if Buck's valuations were using the more conservative end of the range or were at the more aggressive end. MR. SLISHINSKY replied that when Buck did the experience analysis last year they had an element of conservatism in both the mortality and the withdrawal assumptions. Buck also believes that over the long term there is some conservatism on the investment return assumption, although others may argue that over the short term they may be a little aggressive. Buck is using 8.25% as the investment return assumption or discount rate, and the inflation assumption is 3.5%. He mentioned that the investment return assumption for the National Guard and Naval Militia Retirement System is a conservative 7.25%, and that is because the asset allocation for that plan is more conservative.

MR. BADER asked if Buck determined the 7.25% investment return number for NGNMRS by using the same calculation that was done in the experience analysis. He asked further if Buck would be doing the same thing for the Judicial Retirement System or using the same investment return assumption as PERS and TRS. MR. SLISHINSKY replied that Buck looked at the Judicial Retirement System and was using the 8.25% investment return assumption. For the NGNMRS, Buck did the same building block approach — looking at the asset allocation and applying the expected real rates of return for each of the asset classes to come up with a portfolio real rate of return expectation, and then adding the inflation assumption to it to get the nominal rate of return assumption. They took into consideration expenses and some conservatism, to some degree.

MR. SLISHINSKY reviewed a summary of economic assumptions.

Responding to MR. RICHARDS, MR. SLISHINSKY explained that while the total salary assumption is different for PERS versus TRS, there is an underlying economic portion of the salary increase that is the same for both groups, and Buck used an assumption of 4.0%.

MS. HARBO asked if another factor in payroll growth was a larger number of active members. MR. SLISHINSKY said that Buck did not assume that the group would get larger. He added that one of the GASB (Governmental Accounting Standards Board) requirements is that when unfunded liabilities are amortized actuaries are allowed to use a payroll growth assumption, but that should be based on a population that does not grow.

CHRIS HULLA reviewed the health care trend assumptions used in the valuations, saying that they are all built off the underlying economic model assumptions. The price inflation of health care is two to three times that of general price inflation. In addition, there are many other cost drivers in the health care arena - cost shifting from government programs, etc. Buck looked at year-over-year per capita increases specific to the State's retiree health care population and plan design, etc., and they looked long term to balance more recent experience with a longer-term view of how health care costs will increase. Primarily a driver in the long-term view is that, to the extent that health care inflation is double-digit right now and the economy is not growing at double-digit, that relationship cannot be sustained forever. Buck's model for valuations for the PERS and TRS plans and the post-retirement health plan members is to start near current levels and grade down to an ultimate level that in relationship to the implicit economic growth in the other economic assumptions all holds together long term. The medical component of retiree health care is projected to grow at 9.0% in the first year of the valuation and grade down to 5.0% over eight years. The prescription component starts at 13% growth and grades down to the same 5.0% over eight years.

MS. HARBO commented that Buck's standard model for health care trend assumptions did not seem to bear out reality, especially the prescription drug trend. MR. HULLA stated that prescription drugs and hospital bills certainly have not graded down in the last eight years, as Buck is projecting them to in the current assumption. That standard model was adopted by the private sector in the early 1990s, but the experience has not panned out that way. The reaction to that has been to periodically restart the grading down to an ultimate level. What is at least partially supporting that general model is that health care as a percentage of the total economy is growing but at a slower and slower rate. At that macro level, the assumptions have at least proven more accurate than at any employer or plan sponsor group level.

Regarding any of the assumptions, MR. HULLA explained that Buck analyzes all the inputs and tries to develop assumptions that are reasonable standing on their own merits but that combined also produce a valid result. However, no individual assumption will ever be met in any one year; it is a long-term collective process.

MR. TRIVETTE asked if Buck had the health care trend numbers for Alaska's experience over the last three years. MR. HULLA said the recent growth in health care costs, at least on the retiree side, has been lower than the national rates. He added that Buck has a longer-term project to gather enough Alaska data to really develop appropriate trends. Buck needs to be able to look at trends for medical and prescription, but also trends for hospital versus non-hospital components, because the Medicare population is split between those who have Medicare Part A (which primarily covers hospital bills) and those who do not.

MR. TRIVETTE said he would appreciate Buck at some point supplying the Board with those health care trend figures from the last three years.

MR. RICHARDS stated that he understood Mr. Hulla's comment about the economy as a whole, but the State is dealing with a retirement pool, and he thought that health care costs in a retirement pool tended to go up because of illnesses and long-term medications. He said he could understand a health care trend that stayed level in future years, but Buck's assumption is for a trend downward. He said he, too, would like to see the cost figures for Alaska.

MR. HULLA said that the figures he was reviewing were the general per capita increases assumed in health care costs. But there is also an aging or morbidity assumption that reflects that for each year of age there is an additional leveraged health care trend cost increase component. The morbidity curve does not mirror the statistics that 20% to 50% of one's lifetime health care dollars are spent in the last two or three years of life. Some people are dying at age 50 and expending a lot of health care dollars while some people are dying at 80. Overall, the individual curve is averaged out, resulting in the cost increase assumption numbers for the entire population.

MR. PIHL stated that it was wrong to assume that health care cost increases are going to trend downward this quickly in Alaska. Alaska is a young state that is building new facilities that have to be paid for. The providers have to eat a huge amount of their charges, 30%-35%, and the people who have health coverage are going to pay the bill. That will work against health care cost increases trending down.

MR. HULLA explained that the health insurance premium amount is set after analyzing actual claim cost experience, etc. each year, but it also reflects the reserve position of that health plan.

COMMISSIONER KREITZER said she, too, did not see health care rates going down in Alaska. She thought that was a projection made by the previous actuary, and she didn't understand that health care assumption when she sat on the hospital board and she didn't understand it now. She said she was worried about the impact of that on the assumptions.

MR. BADER stated that one of the duties of the ARM Board is to review the actuarial assumptions that are brought to them by the actuary. He said that if the Board takes exception to the assumptions he believed it was within the Board's jurisdiction to amend them. Lowering an assumption would be at some peril, but to make an assumption more conservative would be defensible in almost any instance. He suggested that at the end of the presentation the Board might want to give the actuary some direction if trustees felt the health care trend rates were too conservative, as well as approve the change in investment earnings assumptions that the actuary has brought forward.

CHAIR SCHUBERT asked about the practical effect of restarting the grading down of health care costs to the ultimate level if the assumptions prove not to reflect what is actually happening. MR. HULLA said an example was Buck's June 30, 2005 valuation, where, in light of actual increases and as a conservative reaction to the data available, Buck recommended and put into their calculations that the path from the current higher health care rates down to a lower ultimate rate be delayed one year. So that valuation had a one-year change in the pattern. When the private sector completely restarted the entire model after grading downward six or seven years toward the ultimate health care trend number, it could have a 30% increase in the liability. Another option is to grade the trend over a 20-year period, which would have a very significant impact on the liability.

CHAIR SCHUBERT said her concern stemmed from what happened with the prior Alaska State Pension Investment Board, where the PERS and TRS systems went from a comfortably overfunded status to being significantly underfunded — and it all tied in basically to health care costs. She said she would hate to see this Board slammed with the same kind of situation.

MR. HULLA replied that he understood that part of that change was because the prior methodology was in fact to value those health care plan premium rates that are paid prior to age 60, as opposed to the underlying claims. The year-over-year use of health care plan reserves in setting those insurance premium rates was distorting what really should have been part of the valuation. He said the Board can rest assured that the current process is to look at the claims data. That data is unfortunately at a management summary level at this point, but Buck is collecting and getting at more detail.

Returning to the presentation outline, MR. SLISHINSKY said the actuarial cost method is used to allocate the pension cost from one year to the next. It provides a systematic means of funding future benefit requirements — it is "pay me now or pay me more later." There about six methods approved under GASB for use in determining actuarial contribution rates, and they all get pension plans from point A to point B, although the paths between the two points are different. Buck recommended and just changed to the entry age actuarial cost method. This method calculates the normal cost that if paid from date of hire to assumed retirement age — and all the actuarial assumptions are met — there will be enough money when that member retires to fully fund the present value of their benefits in retirement. The normal cost calculation is the cost of the annual benefit accrual as a level percentage of salary for PERS and TRS pension benefits, since those pension benefits are based on salary. The normal cost calculation is a level dollar amount for the NGNMRS and the medical benefits, since they are not based on salary. The accrued liability represents the accumulated value of those normal cost payments that would be expected to be paid from date of hire for all members to the valuation date.

Buck calculates the total present value of future benefits by projecting salaries and service to assumed retirement ages, and taking that value and subtracting out the value of the future normal cost payments (whether that be on a level percentage of pay or level dollar amount). So they are taking the total and subtracting out the future piece to get the past piece, which is the accrued liability. Then they subtract out the actuarial value of assets from the accrued liability to get the amount that is unfunded as of the valuation date. Then the actuarial contribution becomes the sum of two pieces, one being the normal cost to pay for the accruing benefits during the year for all active members, and the other being an amortization payment of the unfunded liability. That is currently being amortized over 25 years for PERS and TRS, and seven years for the National Guard plan (NGNMRS).

MR. SLISHINSKY next reviewed the asset valuation method. Buck does not use the market value of assets; they are using a five-year smoothing method based on market value.

MICHAEL O'LEARY of Callan Associates, Inc. asked if Buck factors in the expected contributions for the current year when making that five-year smoothing calculation. MR. SLISHINSKY said no, they factor in the actual contributions coming in. If the Fund actually earned 8.25%, they look at the actual contributions and the actual benefit payments and distributions going out to come up with an expected value for the market value from the beginning to the end of the year as if the Fund had earned 8.25%.

MR. SLISHINSKY said Buck does not want the actuarial value of the assets to deviate significantly from the market value so they constrain the methodology to dampen the volatility on the actuarial contribution and also the funded status. This methodology was first used in PERS and TRS beginning June 30, 2002, so it has been phasing into the five-year period. Buck is using the market value for the NGNMRS for this valuation, and then from June 30, 2006 going forward they will phase in the five-year period beginning next year.

MS. HARBO commented that some pension systems use a three-year smoothing, and California went to 15 years. She asked if five years was the best method. MR. SLISHINSKY replied that most common are smoothing methods that are three to five years, five being the most common. He said Arizona has gone to a 10-year period for smoothing. The question about the longer smoothing periods is that the chance of having a larger deviation between the market value and the actuarial value increases. So then the question is if an actuarial value of assets that could be either 135% of market value or 65% of market value is a reasonable assumption.

2006 Actuarial Valuation Results

MR. SLISHINSKY stated that there were no changes in benefit provisions since last year. The actuarial assumptions were changed based on an actuarial experience analysis that Buck performed in 2006. There was no change in the asset valuation method for PERS and TRS. The funding method was changed to the entry age actuarial cost method.

MR. HULLA said the health care base claim cost rate methodology was changed for PERS and TRS based on the results of Buck's 2006 experience analysis. That report described the impact of a portion of the retiree population that is eligible for Medicare that does not have Medicare Part A coverage (covers primarily hospital bills). There is a closed group of retirees - employees hired prior to April 1, 1986 who did not accumulate 40 quarters of coverage under the Social Security System and who are not eligible for free Medicare Part A. Those hospital claims are part of the total volume of claims that were part of the prior analysis. Buck split that out so that those hospital claims not reimbursed by Medicare are applied only to those retirees who do not have Medicare Part A coverage. That decreases the liability because that Part A group is a closed group. Before, Part A hospital bills not paid by Medicare were being spread across everyone, even active employees.

MR. TRIVETTE inquired about the number of retirees who are not eligible for Medicare Part A. MR. HULLA said it is one of the "art" parts of the equation because Buck does not have specific information on individuals. But they look at dates of hire and other hints to estimate that 7.5% of current retirees don't have Medicare Part A and therefore have a much higher hospital bill on average.

MR. TRIVETTE asked if there was any legal reason why the State cannot get the individual information. MR. HULLA said that ultimately it is that person's data, and he understood that the State does not have any claim on the data item that indicates a person has Medicare Part A for free or has to pay a partial premium. He added that Buck has historic data gathered for another project, and they will attempt to use a technique that looks at hospital claims of people over age 65 to see what portion of those have a Medicare component that was paid. That analysis is not perfect and it will only provide information on those people who submitted claims. Buck works with some systems where they are in the initial stages of an outreach program to just go out and ask people for that data. Buck believes that at some point it will be much more cost effective for the State to pay the Medicare Part A premium on behalf of those retirees, especially the partial Part A premium for those who have earned at least 20 Social Security qualifying credits in a lifetime.

MS. THOMPSON requested the dollar amount of reduction in liability due to the change in cost methodology. MR. HULLA said it was significant, in the magnitude of a half billion dollars. He said that is primarily driven by moving the portion of Part A hospital claims that had been applied to everyone over to a closed group. Now, even if the State does not pay the Medicare Part A premium, those type hospital claims will not go on forever as they had been in the prior approach.

MS. HARBO inquired if the Division of Retirement and Benefits was able to gather information about the Medicare eligibility of retirees when they applied for Medicare Part B based on their own work history or through their spouses. FREDA MILLER, a benefits manager with the division, said the statutory requirement is that the plan become supplemental at age 65. The plan is designed to estimate the amount that Medicare would have paid had it been in place for the individuals who are covered by the plan who are over 65. Traditionally, the third party administrator has housed this data, and the division is hoping they can mine better data from the current third party administrator. Also, the division conducted an eligibility verification process in 2006, and they are currently looking at that data.

MR. SLISHINSKY reviewed the July 1, 2006 data for the Public Employees' Retirement System actuarial valuation and compared it to the July 1, 2005 data. He also presented how Buck developed the actuarial value of the system's assets, which increased by 7.1% in the year.

MR. PIHL asked if the disparity between the contributions and the disbursements caused Buck any heartburn. MR. SLISHINSKY said no, because over time a mature plan is expected to pay out benefits that exceed the contribution levels. MR. PIHL observed that it wasn't expected with an unfunded liability like the PERS system faces. MR. SLISHINSKY said that was a different issue, that the contributions have not been sufficient to pay for the full actuarial requirement. Part of that is the two-year delay in implementing the contribution rate and part of it is the history where the increase in the contribution rate was limited. The heartburn is that there is a shortfall in the contributions because of the two-year lag.

MR. PIHL asked if Buck has done a cash flow projection to see how the disparity is going to erode assets. MR. SLISHINSKY replied that the 30-year projections show the expected funded status long term based upon certain policies for determining the contributions and how those contribution rates are implemented.

Responding to a question from MR. RICHARDS about the level of contributions for next year, MR. SLISHINSKY said the fact that the PERS defined benefit plan is a closed fund is going to start changing the dynamics of the active group in the FY07 fiscal year. He made it clear that the contributions amount would still be up when Buck does the actuarial valuation for June 30, 2007 because the contribution rates are increasing. The contribution rates are applied to total payroll, and as long as the actuarial rate each year is met, then the contributions number will keep going up before it starts going down.

MR. SLISHINSKY reviewed Buck's calculation of the contribution rates under the entry age method. He said there were a lot of changes related to changing the actuarial cost method from projected unit credit to entry age and related to assumption changes. Those changes resulted in a 12% increase in the accrued liability. Because the actuarial accrued liability went up more than the actuarial value of assets rose (7% increase), there is a significant increase in the PERS unfunded liability from 2005 to 2006 — from $4.4 billion to $5.347 billion, or about a 21% increase. MR. SLISHINSKY explained that the actuarial contribution starts with the normal cost amount (including both pension and health care benefits) and adds the 25-year amortization of the unfunded liability. Under the level percentage of pay method for amortizing the unfunded liability (which assumes the payroll will grow every year), the total contribution amount is $705 million at July 1, 2006, or 42.06%. Using a level dollar basis for amortizing the unfunded liability over 25 years, the total contribution amount is $837 million at July 1, 2006, or 49.88%. The PERS member contribution remains at 6.84%, leaving the required employer contribution rate at 35.22% under the level percentage of pay method (versus 32.51% last year) or 43.04% on a level dollar basis.

MR. SLISHINSKY also discussed the break-out between pension (56%) and health care (44%) in developing the PERS actuarial accrued liability. He also presented a graph showing the history of the accrued liability split between pension and health care from 1996 to 2006. He noted that the growth in the total accrued liability is primarily in health care benefits, with a moderate increase in the pension accrued liability.

MS. HARBO observed that the big change in the accrued liability in 2002 was after the Milliman audit of Mercer's work, the State's former actuary. So it was not a change in health care costs but a change in the method of measuring health care costs.

MR. HULLA said it went back to what he talked about earlier, that up until 2001 the valuation was based on the health insurance premium charge. For 2002 and later, the valuation was based on the underlying health plan benefits.

MS. HARBO recalled that after the Milliman audit someone from the Division of Retirement and

Benefits made a statement in September 2004 that from that time on 50% of the increase in employer contribution rates would be due to health care costs. MR. HULLA said he could not comment on the exact figures, but it was evident from the graph that the liability for health care is growing faster than the liability for pension.

MR. SLISHINSKY said he recalled that there were two pieces to the change. One was that the health care cost trend rates that were used in the valuation were increased. The second was that Mercer was applying trends to the health care premiums and rolling that forward without looking at the claims costs.

MR. JOHNSON pointed out that Buck's report shows that all of the member contribution is dedicated to pension and none is allocated to the health care component. He asked for the rationale behind that. MR. SLISHINSKY said he believed it was in statute that the member contribution is fully for pension.

MR. SLISHINSKY displayed a graph showing the PERS funding ratio history since 1979. He pointed out that the system was 101% funded in 2001, but changes in 2002 resulted in the funding ratio falling to 75%. There have been erosions in that funding ratio since 2002 so that it is down to 63% in 2006.

CHAIR SCHUBERT asked if that was an extraordinary number in Buck's experience servicing as a consultant to other funds. MR. SLISHINSKY replied that Buck is typically doing valuations on pension funds or health care funds but not a combined system like PERS. The average funding ratio of pension systems is about 87%. But if one considers the health care portion, the PERS system is lower than the average, primarily because of the growth in the health care liabilities.

MR. HULLA stated that there are state systems that have not yet valued the amount of their health care liability, let alone have instituted a systematic way of funding it. So these systems do not even have a funded ratio on the medical side to try to compare Alaska with on an average basis.

MS. THOMPSON said that many systems do not fund health care benefits at all, so the ARM Board should not forget how far ahead Alaska is of so many systems that have not yet even securitized their benefits.

MR. SLISHINSKY next reviewed the July 1, 2006 data for the Teachers' Retirement System actuarial valuation and compared it to the July 1, 2005 data. He noted that annual benefit payments increased to $362 million in FY06, representing 8.4% of market value, which is higher than Buck would typically see for a pension system. Looking at a graph of the 10-year history of the relationship between the actuarial value and the market value of assets, he said it looked very similar to the PERS. Since 2002, when actuarial value was set equal to market value, the relationship between the two numbers has been very close.

MR. SLISHINSKY reviewed Buck's calculation of the TRS contribution rates under the entry age method, using the level percentage of pay basis and the level dollar basis. The accrued liability increased by 11.2% over the 2005 figure. Again, there was a change in the actuarial cost method from projected unit credit to entry age, as well as some changes in assumptions. Because the actuarial accrued liability increased more than the actuarial value of assets, there is an increase in the unfunded liability from 2005 to 2006 — from $2.5 billion to $3.088 billion, or about a 21.6% increase. So the TRS funded ratio is down slightly from 60.9% in 2005 to 57.3% in 2006.

MR. SLISHINSKY reviewed Buck's calculation of the TRS actuarial contribution. Under the level percentage of pay method for amortizing the unfunded liability, the total contribution amount is $318 million at July 1, 2006 or 52.82%, up slightly from 2005. Using a level dollar basis for amortizing the unfunded liability over 25 years, the total contribution amount is $394 million at July 1, 2006 or 65.34%.

MR. TRIVETTE asked why the normal cost for TRS fell from $119 million in 2005 to $109 million in 2006. MR. SLISHINSKY responded that in going from the projected unit credit method to the entry age method it depends on the demographics of the group. While an increase in the rate would be typical, because the active group is older and because of earlier retirements in the Teachers' System, there is really a short period of time between the valuation date and the expected retirement dates of many of the active members, such that most of that cost is in the past. So shifting from one actuarial cost method to another, the rate actually went down.

Returning to how Buck calculated the actuarial contribution rates for TRS, MR. SLISHINSKY stated that subtracting out the member contributions resulted in an employer rate of 44.17% under the level percentage of pay method (versus 42.26% last year) or 56.67% on a level dollar basis.

MR. SLISHINSKY also presented the separation of the accrued liability between pension (67%) and health care (33%) for TRS. The split on the actuarial value of assets is 80% pension and 20% health care. When Buck determines the unfunded liability, even though there is double the amount of actuarial accrued liability for pension, with the allocation of assets, the unfunded liability is very similar to health care — a little more than $1.5 billion.

He also presented a graph showing the actuarial accrued liability history split between pension and health care from 1996 to 2006. There was an increase in the accrued liability for health care benefits starting in 2002, based on the Milliman audit, and there were slight increases in pension accrued liability.

Next was a graph showing the TRS funding ratio history since 1979, which displayed the same kind of pattern as the PERS plan. The funding ratios drastically decreased in 2002, and there has been a slight erosion since then, down to 57% as of June 30, 2006.

MR. BADER commented that the funding ratios continue to slide, even in the face of somewhat increasing contribution rates and good investment earnings. He asked what the Fund would have to earn to keep the funding ratios from declining further, assuming that the money does not come from contributions.

MR. SLISHINSKY stated that if the Fund meets the actuarial contribution rate each year the funding ratios will stabilize. Over time, as the unfunded liability is paid off, the funding ratio percentages will start going up. So that means meeting the 8.25% expected investment return. To the extent that the Retirement Funds earn more than 8.25%, that will help.

CHAIR SCHUBERT called a scheduled break at 10:45 a.m. When she reconvened the meeting at 11:00 a.m., she indicated that some Legislative Finance people in the audience would like to ask questions of the actuary, if there was no objection.

DAVID TEAL, legislative fiscal analyst for the Legislative Finance Division, referred to page 24, where the TRS employer contribution rate for July 1, 2005 was 42.26%. He said 54.03% is what is actually being paid, so there is an extra $60 million being contributed to the Teachers' Retirement System. He asked where and when that extra contribution would show up in Buck's calculation.

MR. SLISHINSKY stated that additional cash infusion contributions will show up in the valuation process at the end of the year in which those contributions are made. Buck has done some studies that take into consideration some cash infusion. To the extent that Buck knows that ahead of time, they can factor it into the valuation, depending on when those contributions are made.

MR. HULLA said if the question was when will the extra contribution help mitigate the otherwise required employer contribution rate, so far in the gain and loss analysis there is a loss due to contribution shortfalls. Coming up there will be a gain because contributions are going to exceed the expected, therefore there will be lower unfunded liability and lower amortization that will play in through increased assets.

MR. TEAL asked specifically when the extra $60 million contribution for TRS that is occurring now would show up in the valuation. MR. SLISHINSKY replied that if the contribution is coming into the Fund currently, then the asset statements when Buck does the next valuation will show that assets increased by that contribution. So the $60 million contribution would be reflected in the valuation as of June 30, 2007. But the employer contribution rates based on that valuation would not be applied until fiscal year 2010.

MR. SLISHINSKY moved on to present Buck's actuarial valuation of the National Guard and Naval Militia Retirement System (NGNMRS). A full valuation of this system is done every two years. This system's retirement benefit is not based on salary and does not include health benefits. He noted that the market value of assets and the actuarial value are the same, and Buck will be applying the five-year smoothing prospectively from this valuation date. Buck also used the entry age actuarial cost method for this year's valuation of NGNMRS. Under that determination, the actuarial accrued liability is $25.4 million. The unfunded liability is $9.87 million. The funded ratio of the plan is down to 61.2%.

MR. SLISHINSKY described the calculation to determine that the normal cost of the annual actuarial contribution as a level dollar amount is $751,000. Amortizing the unfunded liability of $9.87 million over seven years results in a payment of $1.7 million a year, for a total annual contribution of about $2.5 million.

MR. SLISHINSKY drew attention to a graph of the funding ratio history of NGNMRS, remarking on the volatility of those ratios since 1984 and noting that there was probably some cash infusion to fund the system in the late 1990s. The funding ratio is 61.2% in 2006 compared to 68% two years ago.

MS. HARBO noted that the NGNMRS system is funded by the State without any member contributions.

MR. SLISHINSKY reviewed Buck's conclusions. There were gains on the market value of assets for PERS and TRS during the last year. The rate of return (on a cash-weighted basis) was about 11.4% for both PERS and TRS. That is 3.15% greater than the assumed rate of return of 8.25%. That created an additional gain to the actuarial value and an additional delayed gain on the actuarial value, that along with the investment gain during the last year created an investment return on the actuarial value of 9.6% for TRS and 9.7% for PERS. So those rates of return are more than 1.0% more than the 8.25% assumed rate of return on assets. These actuarial gains reduce the unfunded liability and reduce the contribution rate or the amortization of that unfunded liability. A loss on liabilities occurred due to decremental experience and changes in methods and assumptions from the experience analysis. And there were additional gains on liabilities due to health care claims.

MS. THOMPSON said there was actually a gain because the health care claims were less than expected, in addition to the very nice gain on the change in the cost methodology.

MR. HULLA agreed there was a very modest experience gain and a significant methodology change.

Continuing with Buck's conclusions, MR. SLISHINSKY said that on the NGNMRS there were asset losses over the prior two years. The rate of return was about 5.8%, or 2.45% less than the 8.25% assumed. He said there was a return assumption in the prior report of 8.25%, and that has been reduced down to 7.25%. A loss on liabilities occurred due to decremental experience. Buck also reviewed the assumptions in the experience analysis and made some appropriate changes in those assumptions. For PERS, rolling forward last year's unfunded liability of $4.4 billion is expected to increase it to $5.35 billion for 2006. For TRS, last year's unfunded liability of $2.5 billion rolled forward is expected to grow to $3.1 billion for 2006. [An increase in the unfunded liability is expected when determining the contribution rate as a level percentage of payroll and applying that methodology to the amortization of the unfunded liability. That is because the contribution does not fully pay the interest on the unfunded liability.]

MR. SEMMENS said that earlier Chair Schubert had commented that she hoped the ARM Board would not be slammed with the results of inaccurate projections of health care costs. He did not know if this reached the description of "slammed," but when the Board adopted the recommendations made in Buck's experience analysis it had an impact of adding $1.3 billion to the PERS unfunded liability, a more than 25% increase, and there was a similar impact on the TRS side. He noted that that was more than four times as large as the contribution shortfalls that the Board has been focusing on. Without minimizing the impact of shortfalls in contributions, clearly what has caused the largest impact to the unfunded liability of PERS and TRS is what he called inaccurate projections. He said he did not know how to deal with that except to do more frequent experience analyses. He found it disconcerting to see the results every time there is an experience study or audit.

MR. TRIVETTE indicated he supported Mr. Semmens's observations. He said it reminded the Board about how important it is to pay careful attention when looking at the assumptions. He recalled that the experience analysis showed that some of the prior assumptions were hundreds of percents off. Addressing the actuary, he said it would be helpful if Buck could again send the Board a list of the assumption changes and the impacts of those that Buck provided last fall.

MR. SLISHINSKY said that it was helpful to go back to last year's experience analysis and look at the changes not only in the unfunded liability but in the contribution rates that were expected just because of the changes in assumptions and changes in the cost method. Those changes were last year and the impact to the unfunded liability was big, but it is important to look at what has changed since then, which is not of the same magnitude. Changes due to the experience analysis would drop right out. For instance, the unfunded liability on PERS was $5.554 billion, and now the Board is looking at $5.347 billion. So those gains that occurred during the year, exclusive of all those changes, are really bringing down the unfunded liability and bringing down the contribution rate. That is good news from this valuation.

MR. SEMMENS said he had heard the comment a number of times about how in 2002 there was a very large change in the unfunded liability and that it would be amortized over the period 2005 to 2029. What he did not know were the changes for the valuations in 2003, 2004, 2005, and now 2006. He said what he was really struggling with was how the actuarial gains that Mr. Slishinsky just mentioned impacted the change in the 25-year amortization. He wondered, for example, in year number 10 of paying on the 2002 valuation change in the unfunded liability, if the liability would actually be getting paid down. He asked if it would show up as an actuarial gain somewhere, and how that would be treated in the 25-year compartmentalized amortization.

MR. SLISHINSKY explained that the change from one year to the next is the difference between the expected unfunded liability and the actual unfunded. Just as Buck does on the asset side, there is a base that is created and that particular base is amortized over 25 years. So to the extent that there are gains, there is a reduction in the amortization payment based upon the change in the unfunded liability from last year to this year that is amortized over 25 years. That amortization payment of the gain reduces the employer contribution rate and amount. The reports show what those changes were from 2002 each year through 2006.

MR. O'LEARY noted that funding of the NGNMRS plan has historically been very low, and that resulted in a conservative investment policy, which has led to a change in the discount rate from 8.25% to 7.25% for that plan. The investment policy continues to be a very conservative policy. He asked if the policy were changed tomorrow to be more like PERS or TRS if it would result in a change in the recommended discount rate.

MR. SLISHINSKY replied that if there was a significant change in asset allocation for the NGNMRS plan, Buck would review their assumption for the expected long-term rate of return on assets and recommend an appropriate change in that assumption.

MR. O'LEARY said the earnings shortfall in the NGNMRS plan is a shortfall relative to the 8.25%, which is attributable to the more conservative asset allocation. MR. SLISHINSKY said right, that what Buck is doing in quantifying the changes from 2004 to 2006 is looking at the difference between the expected return and the actual return. In 2004 an 8.25% rate was being used as the expected investment return.

Returning to the conclusions and comments, MR. SLISHINSKY reviewed the increased employer contribution rates required for PERS, TRS and NGNMRS, as well as the decline in the funded ratios of the plans over the last year.

MR. HULLA reviewed Buck's conclusions related to the Medicare component:

- The State's medical plan is more valuable to a retiree than what Medicare Part D (prescription drug benefit) would provide, therefore, the State is eligible for reimbursement from Medicare (28% on claim costs within a specific range). That is an offset to the liability that would otherwise be there and is probably the best option at present for a variety of reasons.
- A wrap-around or a prescription drug plan is probably the best long-term option for the State. The State would essentially coordinate with Medicare's Part D prescription benefit (pay some portion of what Medicare does not pay). While this is a better long-term option, it may be difficult to implement, given restrictions on changing the benefits that retirees receive.
- For accounting purposes, the GASB has determined that the retiree drug subsidy payment (from Medicare Part D), being an inter-governmental transfer, cannot be used to offset the present value of liabilities. So the retiree drug subsidy payment will work its way into the accounting picture when actually received from Medicare, whereas currently on the funding side of the house the present value of those projected payments are anticipated.
- Given that a good portion of the medical claims dollars (mostly hospital bills) are for

members who do not have Medicare Part A coverage, that certainly has an impact on the valuation. That has been reflected on an estimated basis as of June 30, 2006, but Buck is working to refine that. The ultimate outcome is a partition to limit the higher costs that are applicable to a closed group of retirees and reduce the liabilities compared to how they have been calculated. Buck is exploring how to determine who has Medicare Part A coverage and who does not, and at what point it would be cheaper for the State to simply pay the Part A premium for retirees, etc. There are a lot of options to deal with this, but the data has to be collected. [Medicare Part A premiums are about $850 a month, and those premiums increase with a penalty if the retiree does not enroll immediately at age 65.]

PERS 30-Year Projections

MR. SLISHINSKY next reviewed what to expect over a 30-year period for the membership groups and the contribution amounts. In a closed group, the active membership will decline over time as PERS members retire and terminate and are not replaced in the system by new members. The decline is rapid at first and lessens over time. As members retire and terminate, the number of inactive members increases over time, maximizes around year 2022, and then declines thereafter as the retiree group dies off and there are fewer active members becoming retired.

MS. HARBO asked if the projected inactive member count included both vested and nonvested inactive members. MR. SLISHINSKY said it was current nonvested members, and the assumption is that in the future anyone who is nonvested who leaves will receive a refund of contributions. But there are people included in the projection who are nonvested who have not taken their contributions out.

Responding to MS. HARBO's follow-up question about the provisions of SB 141 for nonvested members in 2010, KATHY LEA, Retirement and Benefits Manager, explained that on July 1, 2010 if a member has not come back into employment and set up a reinstatement indebtedness for their prior refunded service, they will be unable to set up that indebtedness after that date. So former members who have refunded everything and do not come back into employment are not even in the picture. But anyone after that date, if they terminate employment, can still make the decision whether or not to refund their contributions or leave them in the system, regardless of whether or not they are vested. MR. SLISHINSKY said that was not taken into consideration in Buck's 30-year projections.

MR. SLISHINSKY presented a graph showing the PERS projected contribution amounts from fiscal year ending 2007 through 2037. He said it was based on contributions being made at the calculated rate with the two-year lag, but based on defined-benefit-only payroll and a level percentage of pay amortization. Over time, the level percentage of pay amortization increases, but there is no increase in payroll because the defined-benefit-only payroll is being used, so losses occur. And also the fact that there is a two-year lag in applying the contribution rates, the actual amounts are not being contributed, so there are losses there. As a result, there is an increase in the amount of the contribution, not only over the next 22 years, but also after 2029 those losses continue to require amortization payments.

MR. SLISHINSKY presented a graph showing the PERS projected contribution amounts from 2007 through 2032, with calculations at the actuarial rate applied to the total defined benefit plan and defined contribution plan payroll, determined on a level percentage of pay amortization. By 2033 the unfunded liability is eliminated.

MR. SLISHINSKY said the next graph was for illustration purposes only. It showed the projection of PERS contributions at the current calculated rate of 35.22% based on total payroll and a level percentage of pay amortization for the entire 30-year projection period. The contributions continue to go up as they are based on both the defined benefit and defined contribution payrolls.

MR. SEMMENS commented that the ARMB would not want to do this. He said he wanted to see the contribution rate that is needed to amortize the unfunded liability over 25 years that is the defined benefit and defined contribution level percentage of pay amortization rate amount. Referring to the previous graph, he said it looked like the projected dollar amount contributions would pay off the unfunded liability by 2033, which was a target date that he liked. But the graph showing projected contributions at 35.22% indicated that the maximum contribution would occur around 2016 or 2017, implying that the contribution rate would drop every year thereafter. But he did not recall having seen a graph that depicts that. He said he was frustrated and wanted the Board to get that sort of a projection because of the Board's rate-setting obligation and for long-term planning purposes. He asked that either the Board or the Department of Administration formally request that information from Buck Consultants or someone else.

MR. SLISHINSKY said he understood that Mr. Semmens wanted to see projected contribution results (based on total defined benefit and defined contribution payroll) on a percentage of pay basis as opposed to a dollar amount basis. That will provide a picture of declining contribution rates over time as the unfunded liability that is being paid over 25 years is paid off.

MR. SEMMENS speculated that one would not see the contribution rate dramatically declining in year 2030 and beyond, as depicted in Buck's graph. He preferred to see a more smoothed curve all the way across the period such that years 2030, 2031, 2032 and 2033 would continue the downward slope. He said he did not understand the big drop in the contribution rate shown for year 2030. He suggested that perhaps actuarial science and GAAP (generally accepted accounting principles) would say that the State could not do that, but he thought the ARM Board had the authority to set contribution rates that it believes are best, and if there are accounting or reporting issues, then so be it.

MR. SLISHINSKY replied that Buck could show what the contribution rates would be based upon the data. But if you were to change the methodology for amortizing the unfunded liability over a fixed 25-year period such that it forces you to amortize all unfunded liability in 25 years — because what you are seeing in the years 2030 through 2032 are the amortization payments for those changes that occurred since 2002 through 2005. The methodology being used right now is each year there is a new little piece that is being determined and amortized over a new 25-year period. So the initial piece that was created in 2002 is amortized with that 2029 year payment and then it is done. In theory, if all the assumptions are met and that experience is being realized, there are no new pieces or unfunded liabilities to be amortized. And that is why after 2032 there are no contributions required.

MR. SEMMENS asked the Department of Administration if they thought there was merit to the idea of amortizing the full liability over 25 years, rather than the actuarial methodology which amortizes changes in the unfunded liability from each year and amortizes those over 25 years. He thought there was merit to developing a plan to get the unfunded liability to zero in 25 years instead of what Buck's graphs indicate. He did not see a particular benefit to employers who are tasked with funding the unfunded liability to use the actuarial method that causes high contributions and increasing contributions and then have it fall off the table prior to the end of the 25-year period.

COMMISSIONER KREITZER stated that she went through this many times during the legislative session, and there was a lot of consternation on behalf of people who looked at graphs like this that trailed off at the end. She said it was disconcerting to hear that certain things were not considered in some of the graphs, like the projected inactive member count that does not take into account the 2010 ramifications. She wanted to pursue getting that included the next time around. She indicated that the Department of Administration would work on Mr. Semmens's request and report back to the Board.

Moving on, MR. SLISHINSKY referred to a graph showing the sensitivity analysis as if the actual rate of return for the PERS plan was different than the 8.25% assumption. If the plan earned 7.5% per year the impact would be to increase the contribution amount due to asset losses that are then amortized and increase the calculated contribution rate. If the plan earned 9.0% per year, there are gains created that decrease the contribution amount and the calculated contribution rate. The impact of these scenarios by the year 2029 is significant.

LUNCH RECESS

CHAIR SCHUBERT called a break for lunch at 11:55 a.m. When the meeting reconvened at 1:15 p.m., besides the Chair, Trustees Trivette, Harbo, Semmens, Pihl, Williams and Richards were present. Commissioner Kreitzer rejoined the meeting at 1:34 p.m.

2006 VALUATION REPORT REVIEW - PERS/TRS/NGNMRS (Continued)

TRS 30-Year Projections

MR. SLISHINSKY reviewed the 30-year projections for the Teachers' Retirement System, starting with the projected active member count by tier 1 and tier 2. TRS shows the same general pattern as seen in the PERS projections. There are roughly 9,800 actives that are expected to decline to almost zero by 2037, since all new hires go into the defined contribution plan. He also reviewed the inactive count.

MR. SLISHINSKY presented several contribution scenarios, for illustration purposes: (1) the TRS projected contribution amounts at the calculated rate based on defined-benefit-only payroll and level percentage of pay amortization; (2) the projected contribution amounts at the calculated rate based upon total payroll using both defined benefit and defined contribution retirement payroll and a level percentage of pay amortization amount (the amount of contribution goes up as total payroll goes up); and (3) the projected contribution amounts at the current contribution rate (44.17%) using total payroll and a level percentage of pay amortization.

MR. SLISHINSKY reviewed the TRS projected funding ratio with contributions at the current rate of 44.17%. The TRS fund becomes fully funded by the year 2028. He presented the sensitivity analysis for a range of investment returns, from 7.5% return at the pessimistic end to 9.0% at the optimistic end. So over time there would be a difference in the calculated contribution rates due to either gains or losses in investments, and by the year 2029, that contribution difference could be as much as $100 million plus or minus based on whether or not the fund had gains or losses.

GASB 43 and GASB 45

MR. HULLA next covered progress toward resolution on a couple of rules from the Governmental Accounting Standards Board. These have to do with the assets being appropriately allocated to pension and health care, and that allocation will drive the ultimate results under GASB 45.

MR. HULLA stated that GASB statement 43 is a promulgation of rules of how plans must account for their funded status. GASB statement 45 requires that employers must reflect their obligations toward those plans and benefits on their financial statements. The only significant differences between what current practice is and what GASB rules require is that the retiree drug subsidy under Medicare Part D cannot be prospectively recognized as a reduction in obligation — it will only be reflected when the State receives that cash. And there is a discount rate to be used for health care accounting purposes as a function of the rate at which the plans are funded, as opposed to the 8.25% that is currently used.

Regarding GASB 45, MR. HULLA explained that Buck did reconstruct a history of contributions and benefit payments, and their estimate of earnings for each year for the PERS and TRS plans from about 1976, bringing those assets forward. Ice Miller is putting together a presentation of that information to the IRS to make a case for an allocation of some assets to health care and the remaining assets to pension. The worst case outcome of that whole process is if the IRS were to say that the assets have to be all "restored" to the pension plan, then there would be no assets left on the health care side. That is a negotiation process with the IRS. In the meantime, per the auditors of the financial statements for the State, the appropriate assets to show are the assets that have traditionally been allocated.

MR. HULLA also discussed the assumptions used to illustrate the impact of GASB 43 for FY09. He explained that the annual required contribution (ARC) is the accounting amount for medical which is the cost of providing the benefits on an annual basis, but is not the same as funding them (it is the accounting recognition of those costs). The annual required contribution is the employer contribution amount that actually goes into trust for the pension benefits and which has funded the retiree medical benefits. The assumptions used were:

- 8.25% return on the funding side.
- 4.5% discount rate to calculate liabilities and impound normal costs for the accounting annual required contribution. That is because, looking back at the amounts contributed to the health care side of both the PERS and TRS plans, those amounts did not cover the full cost of benefits paid out of those plans. So in a sense the plans were borrowing a bit in terms of the contributions. GASB says look back at the year you are accounting for and establish a discount rate based on that year's activity. Unfortunately, it is not a long-term analysis that looks at what assets will return based on the investment allocation. Instead, per the rules, it looks at the cost of the health care provided, less the premiums back from retirees under the age of 60, and compare that all to the amount of assets that actually went into the trust, and the result is the nearly liquid rate of return of 4.5% (as opposed to any equity investments, etc.).

MR. TRIVETTE asked if the 8.25% and 4.5% rates were included in the GASB 43 statement. MR. HULLA said not the rates themselves; the statement simply says the discount rate to be used has to reflect the expected return on the assets set aside for that. He added that 4.5% is the rate that Buck recommends based on their understanding of the general fund right now, and their other assumptions used to build up to the 8.25%. But what the State is locked into is that to be allowed to use a discount rate greater than 4.5% for accounting purposes the State has to fund more than the "pay as you go" cost in a given year. For this particular year (2010), that was not the case. The cycle after this, fiscal year 2011, it will be the exact opposite. Based on the contributions made, the discount rate will be at 8.25% because the Fund will be well above the "pay as you go" rate. The discount rate used is based on the amount actually contributed.

MR. O'LEARY asked if the 4.5% rate was a proscribed rate or if there was a linkage to a particular index. MR. HULLA replied that it comes from essentially the risk-free or very low risk components that build up to the 8.25%, therefore, founded essentially on the assumed inflation rate, etc. He added that other systems that are purely "pay as you go" are using anywhere from 3.5% to not much more than 4.5%. So there is no proscribed rate of return, but it is theoretically built from the assumed inflation and risk-free rate of return - that kind of analysis.

MR. O'LEARY said he understood Buck's inflation expectation was 3.5% long-term, so when Buck uses an assumption of 4.5% long-term return on assets they are talking about a 1.0% real return. Yet one could reasonably expect more like a 2.0% real return on Treasury inflation-protected securities (TIPS).

MR. HULLA indicated that he was not familiar with TIPS.

MR. O'LEARY said the securities have no credit risk. He added that he understood Buck's answer that the 4.5% rate was their professional judgment that has to be consistent with their willingness to accept an 8.25% rate.

MR. SLISHINSKY said also the way in which the general fund assets are being invested. MR. HULLA said to get to a 5.5% discount rate, for example, you would have to segregate specifically for this purpose the TIPS-type investments as opposed to how the general funds are currently invested across the entire board.

MR. SEMMENS commented that Buck's statement that the 4.5% discount rate was temporary did not appear to be correct because he did not know when the contribution rate would equal the annual required contribution. He said it looked like Buck was assuming that the contribution rate would equal the annual required contribution next year. He did not know how the ARMB would get there, given that the total annual required contribution was 39.76% and he did not expect this Board to do that. He said Buck's statement allaying Mr. Trivette's concerns that this is temporary was not accurate, but if it was, they were free to disagree with him. He thought that was totally a function of the rate that the ARM Board sets, and if the Board sets a rate of 22% for FY09, which is on the agenda, then he didn't think that would meet the annual required contribution. If the Board set a rate of 32.5% for FY09, which is the rate based on a level percentage of pay, he did not think it would meet the annual required contribution. So he was concerned about Buck's statement.

MR. HULLA indicated that he understood the concerns. He said the 4.5% discount rate is not temporary in terms of it just being here for a year or two and then it would be at 8.25% forever. He said he might be wrong but he understood that the path had been laid out to fully fund at least the annual required contribution for one or two years.

MR. SEMMENS said he thought Mr. Hulla was right, that the action the ARM Board has officially taken is to set the rate equal to the annual required contribution. Given that, the Board would expect to use an 8.25% discount rate in fiscal year 2011 (based on the FY08 valuation). He said he was afraid that unless the Board did something to address this they were going to see a very markedly different unfunded liability figure from year to year for health care, based on this discount rate. He thought the Department of Administration should consider allocating the $185 million that is coming in from the State such that the actuarially required contribution for health care is met. He said he did not know anything about how that $185 million was going to be distributed, but if it can be distributed such that the actuarially required contribution for health care is met, it will remove the need to use the tremendously low 4.5% discount rate, and hence the unfunded liability will be much lower. He said he personally did not want to face the Legislature and tell them that the unfunded liability for PERS health care just went from $6.3 billion to $11.5 billion for accounting purposes. If the Board could avoid that, it should.

MR. HULLA stated that to the extent that the annual required contribution is fully funded for fiscal 2011, however that is done, and then not at all for the next year, it could jump from $6 billion to $11 billion and back again every year. Those are then end points. What portion of the employer contributions is contributed on a consistent basis will determine how much of that volatility there is based on that discount rate for accounting purposes.

MR. HULLA moved on to a page showing the results of GASB 43 for the PERS health care based on the methodology used in the past for allocating the assets and with different treatments of the retiree drug subsidy coming back from Medicare Part D.

MR. SEMMENS asked if the PERS pension side is under-funded in terms of the accounting annual required contribution, if it would have any impact on the discount rate used. MR. SLISHINSKY replied that you would always use the 8.25% discount rate on the pension side. The GASB 43 requirement is only for health care.

MR. SEMMENS said it was clear to him that the $185 million should get applied to whatever the annual required contribution is for health care, if it is legally possible to do that. It would make a $5 billion difference in the unfunded liability for health care.

MR. WILLIAMS indicated that he thought there were limitations as to how much of the $185 million contribution could be put toward strictly health care. He said there are maximum contribution limitations under the Internal Revenue Code 115.

MR. SEMMENS asked Buck if the ARM Board could realistically expect to see the unfunded liability for health care at $11.5 billion in FY09 or if the information was illustrative. MR. HULLA replied that assuming there is no resolution to the asset allocation, and the auditors then say to continue with the current asset allocation, it acts as a component of this — for accounting purposes. But the main driver is the 4.5% discount rate, and that is because of the actual contributions versus the actual expense in FY06.

MR. SEMMENS said it would be an interesting discussion when it comes out that for accounting purposes the unfunded liability for health care is $11.5 billion but that on some other basis the liability is $6.8 billion. MR. HULLA commented that, without casting aspersions on GASB 45, he would call the $6.3 billion a rational funding basis.

MR. PIHL inquired who set the 4.5% discount rate. He said he understood it was the outcome of the government using the Treasury discount rate for unfunded pension plans when they go after employers, irrespective of what a pension plan may have experienced in earnings. He said he knew of an underfunded pension plan that had average earnings of 9.23%, and the government is forcing them to use the 4.5% rate, irrespective of their earnings history.

MR. HULLA replied that he suspected the 4.5% rate in the example that Mr. Pihl cited was a required rate from the IRS or the Department of Labor to ensure adequate funding for some benefit. The fact that the rates in Mr. Pihl's example and in Buck's calculations are both 4.5% is coincidental. Buck recommended the 4.5% discount rate based on the whole economic model that is driving the 8.25% earnings assumption, the health care cost trend rates, etc. The recommended rate for just general assets, without any specific higher-return investments segregated specifically for post-retirement medical, is 4.5% in Buck's analysis. But for GASB 43 and 45 accounting purposes, the Board will see other systems using 4.0% or 4.25%. So the 4.5% rate is not dictated; it is Buck's recommendation of what they think the assets available for other post-employment benefits are. And it is all because no assets are specifically segregated for that purpose that Buck would expect to earn more than this rate.

MS. HARBO remarked that a couple of states have opposed the use of GASB 43 and 45 rules, although she understood those states do not prefund health care benefits.

MS. THOMPSON said she attended a Government Officers Finance Association (GFOA) meeting on Saturday, where they talked about what is going on. The Texas legislation that is on the governor's desk does not make it mandatory to not comply with GASB 43 and 45 in Texas. But the municipalities they were talking to at the GFOA level are stating that they will still comply because of concern over bond ratings. The bond rating agencies may or may not comply with this Texas legislation. To date, she only knew of Texas and Connecticut as states that are working to oppose these GASB rules.

MR. SHIER asked which annual required contribution the $407 million shown as the cost of post-employment health care on page 17 represented. MR. HULLA said it was the funding annual required contribution (not the ARC for accounting purposes), and it was based on 8.25% and reflected the offset for Medicare Part D. MR. SHIER then asked what the accounting annual required contribution was. MR. HULLA said the difference was that there is nothing dictating that the amounts calculated under GASB 43 or 45 actually be used for funding. To date, the ARM Board's policy for funding has been to project out on a best-guess basis the actual cash flow (net of retiree drug subsidy) and discount that back at the amount that the entire Fund is expected to earn, 8.25%, and that is the basis of the funding annual required contribution. Buck is making that distinct from the accounting annual required contribution because of the nuances in the accounting rules that say plans cannot do the accounting annual required contribution exactly the way that Alaska currently does its funding calculation.

MR. SHIER asked, if $407 million ended up in a post-employment health care account of some kind at the end of this period, if 8.25% would be the discount rate for the next period. MR. HULLA said yes, with the two-year lag that is based on this activity.

MR. JOHNSON said he understood that the accounting annual required contribution was a disclosure item. He asked if the ARMB can only pick between the 8.25% fully funded plan rate and the 4.5% unfunded plan rate, and if the argument is that Alaska's is a partially funded plan, could there be a discount rate somewhere in between.

MR. HULLA replied that if in FY06 the contribution had been more than the pay-as-you-go cost for the post-retirement medical benefits, then following all the rules and logic, Alaska's plan would be somewhere in the middle. It just happens that based on the actual contribution activity versus the actual expenses of health care benefits (as opposed to using the premiums, etc.) that the actual amount contributed is less than the pay-as-you-go cost, so that dictates the 4.5% discount rate. But if in year five from now the contribution is 150% of the pay-as-you-go cost, that 50% extra is an amount that is used to calculate a rate in between the 4.5% and the 8.25%. That would be partially funded from the accountant's perspective.

MR. SEMMENS commented that when something is for disclosure that usually means in the notes to the financial statements. But the retirement systems also have to book the net pension obligation on the entity wide statements, so there is a financial statement impact to using the 4.5% discount rate. MR. HULLA mentioned that it will accumulate every year.

MR. SEMMENS said that if Alaska goes to a cost-share plan, then employers do not have to deal with that, only those people at the Division of Retirement and Benefits who prepare the retirement plan financial statements.

Returning to the presentation slides, MR. HULLA stated that there are significant differences for PERS and TRS when looking at the accounting actual required contribution based on the FY06 actual contribution activity and actual cost under the plans. It happens to be, based on FY06 activity, that the plans are beyond that end point, and one extreme of the end point is the 4.5% discount rate, which basically doubles the liabilities when compared to an 8.25% discount rate and more than doubles the accounting actual required contribution compared to the funding ARC. To the extent that contributions exceed cash flow in the future, that whole picture will change. It could go from 4.5% to 8.25% in one year and flop back again, or come up somewhere in the middle, year after year. And each year the extent to which the accounting actual required contribution exceeds the amount actually funded, that amount will be an increase to the liability on the books at year end.

MR. TRIVETTE asked who was supporting the GASB 43 and 45 rules. MR. HULLA said he understood that the Governmental Accounting Standards Board felt that the lack of recognition of governmental-sponsored other post-employment benefits was not an accurate reflection. MR. TRIVETTE observed that Alaska was being penalized for what all the other pension plans were doing. MR. HULLA remarked that accounting reality is not always economic reality.

MR. SHIER mentioned that his division would do what it could to provide any data that was requested at this meeting. He said he would coordinate with Mr. Bader about the appropriate time and place to do that.

Questions and Answers Session

Buck Consultants handed out updated slides containing their responses to the following questions they had received from ARMB trustees and staff. They reviewed and answered each question, and in some cases deferred to the Department of Administration staff for responses.

1. How much was in the Governor's original budget to address the PERS/TRS unfunded liabilities? *[referred to Commissioner Kreitzer]*

COMMISSIONER KREITZER reported that the Legislature appropriated $185 million to deal with PERS to bring the contribution rate down to 22%, and appropriated $269 million for TRS. She indicated that David Teal had done some additional work from which she would try to extrapolate out the numbers. The Governor had proposed $700 million to go toward the unfunded liabilities. What ended up coming out in the legislation that was passed was a total of $551.8 million from the State to address the unfunded liabilities.

MR. PIHL asked if the $551.8 million included the State's employer contribution for its own employees.

COMMISSIONER KREITZER replied that SB 53 included $269 million for TRS and $307 million for PERS for a total of $576.3 million. In addition, the normal contributions were $327 million, and an amount paid by others to address unfunded liabilities of $24 million. So total contributions for the State for all employers was $903.7 million.

MR. PIHL recalled a $505 million figure that was the number built into the suggested budget. He also recalled another $500 million at one time. That was money in addition to everyone's contributions, which was going to strictly address the unfunded liabilities, and it was to cover the difference between the rates that were being paid and the actuarial rates which the ARM Board adopted last October. He said he wondered how the new numbers in SB 53 compared with the numbers he recalled. He also wanted to know what year the additional money would come into the pension funds, if it would be before June 30, 2007 and be counted as part of the assets.

COMMISSIONER KREITZER explained that SB 53, which is not yet in front of the Governor for signature, stipulates that $185 million is appropriated to the general fund as partial payment of PERS contributions for the fiscal year ending June 30, 2008. That means the effective date of that section of SB 53 is July 1, 2007, so the money will not be going into the fund until after that date.

MR. PIHL reflected that the Board would be seeing another June 30, 2007 PERS actuarial valuation report where the unfunded liability would be up to $10 billion or more. COMMISSIONER KREITZER said she expected that was correct.

Responding to MS. HARBO, COMMISSIONER KREITZER said the $185 million would be deposited July 1, 2007 or thereabouts; there is no anticipation of spreading the deposit out over the year.

MR. WILLIAMS asked if Buck had rerun the numbers taking the State's additional contributions into account, and if the added contributions had the effect of reducing the employer contribution rate down to 22% for PERS and 11.56% for TRS.

MR. SLISHINSKY said no, that the only calculations that Buck did was for a proposed $500 million contribution to TRS.

Referring to Mr. Pihl's earlier remarks, MR. SEMMENS said the $505 million was to cover the increase in employer contribution rates from what they were paying in FY07 to the actuarially required amount on a level dollar method applicable in FY08. He recalled that what happened was the Legislature, particularly the House Finance Committee, determined that because SB 123 was going to pass, both defined benefit and defined contribution plan salaries could be used, so therefore they could reduce the contribution needed from $505 million to a lower amount for PERS. In fact, that happened for PERS, but it did not happen for TRS. The full impact of the TRS change was budgeted, but the full impact to the actuarially required rate was not budgeted for PERS. Instead, it was taken to the level percentage of pay rate. That is why the $505 million figure was reduced by $124 million.

CHAIR SCHUBERT asked fellow trustees to limit the amount of time on each question without restricting discussion so the Board could get through the whole list of questions today.

2. What is the State contribution to the unfunded liability?

MR. SLISHINSKY stated that for FY08 the State is contributing $185 million to PERS and $270 million to TRS. The State contribution is the difference between the Board-adopted rate and the 22% for PERS and 11.56% for TRS. For individual PERS employers that have a rate less than 22%, the State will pay the difference between the 22% and the employer rate.

MS. HARBO asked if the TRS employer contribution rate was 11.56% or 12.56%. MR. TEAL said it was 12.56%.

COMMISSIONER KREITZER corrected Mr. Slishinsky's last statement. She said if the PERS employer's contribution rate is less than 22%, then the employer is going to pay whatever that rate is — to the floor of 14.48%. For example, if an employer's rate is 17%, the employer is going to pay the 17%, and the State is not picking up the difference between 17% and 22%.

MR. SLISHINSKY stated that the full rate would not be paid then, if the ARM Board sets a rate above 22%.

COMMISSIONER KREITZER said the Legislature proposed this as a one-year solution, and it is not something that necessarily continues on into the future.

Assistant Attorney General MIKE BARNHILL stated that in the example used the 17% is the full rate for that employer, so there is no difference to pay. There are a couple dozen PERS employers whose contribution rates are below 22%.

MR. TEAL explained that the point about PERS employers with rates lower than 22% came up a number of times as the Legislature worked through the FY08 funding. At one time the rate was going to be 22% and everyone would pay it, and there was a provision built into the law that those communities with a rate assignment lower than 22% would get payments from the State and be essentially held harmless. Since the employer contribution rate did not go to a blended rate, and every employer doesn't pay that blended rate but pays their own rate, there is no reason to hold them harmless. So if an employer's contribution rate, assigned by Buck as a level percent of pay rate, is 17%, there is no reason to make up the difference between 17% and 22%. The whole series of employer contribution rates going from 14.48% to 185% averaged 32.51%. If every employer paid the rate they were assigned, there would be full payment. There is no need to subsidize the rate between 17% and 22%, and there is no money missing. All the legislation says is that those employers with a rate above 22% will pay 22%, and the State will pay any amount above that.

3. What are the ramifications of level dollar or level percent of pay?

MR. SLISHINSKY reviewed two graphs to illustrate the difference. He said initially the level percentage of pay payment amount is less than the level dollar payment amount, but it increases as payroll increases, so over time there is more money paid on a level percentage of pay basis. Looking at the impact on the unfunded liability by making amortization payments, the dollar amount using the level dollar method is sufficiently large to pay for the interest during the year as well as some principal payment on the unfunded liability. So as a result, the unfunded liability goes down over time. The level percentage of pay method in the early years is not large enough to pay for interest on the unfunded liability. It eventually increases over time until the amount of the contribution is large enough to pay the interest and then some principal of the unfunded. Both methods will amortize an unfunded amount over a 25-year period. It is just that the payment amounts are different.

MR. PIHL asked if Buck had calculated the difference in employer contributions on the two approaches. He thought it was something like an additional $6 billion because the money is not in the Fund earlier to invest.

MR. SLISHINSKY said he believed that came from a projection that Mr. Teal performed. MR. TEAL indicated that he did a spreadsheet verifying how Buck got their numbers and compared the two methods, but he could not recall the number that Mr. Pihl mentioned.

4. Do we need to use level dollar?

MR. SLISHINSKY explained that before SB 123 the employer contribution rate was applied to defined benefit plan payroll only. Use of a payroll growth assumption is not appropriate once the plan is closed to new entrants and the defined benefit payroll is not expected to increase. So the ARM Board must use a level dollar amortization method. After SB 123, which uses both defined benefit and defined contribution plan payroll for applying the employer contribution rate, it is possible to use a payroll growth assumption, although it is not required. However, for GASB purposes, it does state that the annual required contribution is calculated over the active members' salary. So the ARM Board has to use defined benefit plan salary as the basis for determining that annual required contribution, which means not using a payroll growth assumption for determining the ARC or amortizing the unfunded liability. Under GASB, there has to be disclosure when the employer contribution is less than 100% of the annual required contribution.

5. Please provide the following information:
    - Show the actuarial accrued liability by tier, broken out by pension liability and health care liability.
    - Show the actuarial value of the assets by tier.
    - Show the unfunded liability by tier.
    - Show the funding ratio by tier.
    - Show the information presented on slide 5 of the August 30, 2006 presentation to the Board, broken down by tier.

Buck provided charts of this information for PERS and TRS on slides *(on file at the ARMB offices).* MR. SLISHINSKY noted that the assets are not accounted for by tier, so technically Buck cannot calculate the unfunded liability by tier or the funding ratio by tier. But in order to illustrate what those would be, Buck assumed that the assets would be allocated to each tier on the basis of the accrued liability, so in essence the funded ratios would be the same by tier and in total. So the rates go down by tier primarily because there are more actives in tier 2, and even more actives in tier 3 and more salary.

6. Please present ideas to shorten the lag time between the valuation report stating a recommended contribution rate and the implementation of that rate.

MR. SLISHINSKY said that currently the lag time between the valuation date and the beginning fiscal year for application of the contribution rate is 24 months. So the contribution rates from the June 30, 2005 valuation are applying to the fiscal year that begins July 1, 2007. He referred to a memorandum from Charlene Morrison, former financial officer for the Division of Retirement and Benefits, that outlined four options for the Board on addressing this time delay, as follows:

- Rates become effective after the start of the fiscal year. So with new information from the actuarial valuation, go back and change the rates for that fiscal year. Issues with that are that the employer budgets are already set, employers are not receptive to rates changing during the fiscal year, and the State's Office of Management and Budget does not want to set rates based on estimated rates.
- Change the valuation date to December 31, instead of June 30, but still use the same fiscal

year. That shortens the lag time from 24 months to 18 months. However, an 18-month lag does not really provide that much more accuracy. There are programming changes that are necessary to collect information at a census date of December 31 instead of June 30. It would require programming changes for Buck to take that data for a different census date. The financial data as of December 31 is not audited. And there would be a six-month valuation year that would cause problems with the next experience analysis.

- Develop rates using a one-year roll forward of the liabilities and the current assets. That would reduce the lag time to 12 months. The roll-forward rate would not be significantly different than the actual rate. The assets used to calculate the contribution rate would need to be provided before the audit was completed, so there might be a slight difference between those assets and the assets that are shown in the audited report. PERS employer level rates may not be able to be determined in this short time frame. Buck could come up with the consolidated rate for PERS by September, but it would take some additional time to calculate rates for each individual employer. Finally, it would reduce the time frame for the second actuary review and for the Board to adopt the contribution rates.
- Adjust the contribution rate for the two-year lag. That would be taking the contribution rate and rolling it forward, adjusting it with interest, and converting that to a percentage of pay that is projected pay during that fiscal year to come up with the rate. It would still be using the same fiscal year end valuation results, the assets would be audited, and there would be enough time for a second actuary and the Board to review.

MS. HARBO said that somehow the lag time between the actuarial valuation date and implementing the contribution rate has to be reduced because it creates an unrealistic situation for rates. She hoped Buck was working with the Department of Administration on that. She also said the Board needs to get the valuation reports earlier, maybe in March. The Board has been getting the valuation reports later and later and then having to set the employer contribution rate later and later, and it is not good for planning.

MR. TEAL stated that the lag time could be reduced to virtually nothing. Assuming SB 125 passes, or one way or another a flat rate is implemented, the Board could set the PERS rate at 22% for employers and the TRS rate at 12.56%. The Board could set the rate for FY09 and FY10 if it wanted to. The time lag is because of the budget process because the State needs to know how much money it needs to kick in.

MR. PIHL commented that the statute under which the ARM Board was created would have to be changed. The statute charges the Board with seeing that the money is there to meet the benefits. So if the Board does not have any role in what the total contribution is going to be, then that statute needs to be changed. He added that taking that responsibility away from the ARMB would be fine with him.

MR. TEAL explained further that the Board has numbers it is using right now to set the FY09 rates, but, with a statutory change, the Board could just as well be setting FY08 rates with those numbers.

There are rules the Board has to follow. But if the lag is really a concern, it can be addressed by the Legislature, if necessary, or by the ARMB to the extent that it can do it. He said the only concern is how the State knows what the rates are and how much to contribute. And no one knows if the FY08 rates are correct right now. The Legislature put in $185 million for PERS, and if payrolls come in different than anticipated, then $185 million is not going to be sufficient. So there may or may not be a supplemental appropriation required to address the State's share, but that is a pretty simple budget procedure.

7. What are the effects of closed systems on the investment program?

MR. SLISHINSKY stated that the plan is closed to new entrants, but current members continue to accrue benefits. The plan potentially can continue to pay benefits over 80 years, until the very last survivor or beneficiary receives the last payment. Since contribution rates are applied to defined benefit and defined contribution plan payroll, contributions will continue into the plan long after the last defined benefit member retires. (That is different from a normal closed plan group, where the contributions are based just on the payroll of that group.) As the plan matures, most of the liability moves into payment status, and contribution rate risks are primarily mortality risk and investment return risk, with most of it being investment return risk. Increasing asset allocation conservatism for mature plans will dampen the volatility of funded ratios and contributions. But by the Board investing the assets more conservatively, the actuary would have to reduce the expected rate of return on assets, which in turn would increase the contributions. The TRS plan, with 65% retired members, is more mature than the PERS plan, where the split between active and retired members is roughly even.

MR. O'LEARY said that if the Legislature had not clarified that the total payroll was the appropriate base for contributions, then without any question the Board would have been well advised to become much more conservative in the asset allocation, because the contribution risk would have been that much greater. So passage of that clarifying legislation was very significant in terms of providing a range of investment options to the ARM Board. He said that although people are probably well aware of it, he has not heard mentioned in the discussions that as time goes by there will be greater concern that all the dollars that are going to support retirement are going to a group that is not even working anymore, and the then-actives may or may not think that that is a reasonable solution.

MR. SLISHINSKY stated that as the active group covered in the defined contribution plan gets larger over time and the greater their salaries, the lesser the amount as a percentage of payroll contribution would be needed for the defined benefit plan. So to the extent that there is investment risk and volatility on the investments, the change in the percentage of pay contribution is lessened.

8. How many years will it take to pay off the unfunded liability?

MR. SLISHINSKY stated that the current amortization method amortizes the unfunded liability over a 25-year period, based on level percentage of pay payments. So to the extent that that calculated rate is paid, the last piece of the unfunded liability would be paid off during FY29. Current projections show the TRS plan become 100% funded in FY29 and the PERS plan in FY28 due to the deferred gains on the assets. This assumes no additional cash contributions or pension obligation bonds during the projection period.

9. Our projections are based upon the assumption of an 8.25% rate of return on investment. Returns have been much higher. So instead of getting 8.25% on say $15 billion, we have received the higher return on the full amount invested. Should we not be using that actual number, and if so, what would the impact be on the unfunded liability over the last four years or so?

MR. SLISHINSKY said this question goes back to the sensitivity analysis that Buck showed earlier. Because the investment returns have been much higher than 8.25% over a short period of time doesn't necessarily mean that the Board can expect that level of return in the next four years or over a 25- or 30-year period. However, if PERS and TRS were to earn 9.0% a year, the contribution amount by 2029 would be $100 million less, and for PERS the reduction would be about $200 million.

10. We have heard many comments recently from various "experts" about what funding level the ARM Board should strive for. Some have suggested that anything over 80% would be fine. What is the opinion of Buck and Gabriel Roeder Smith? What do they base their opinion on?

MR. SLISHINSKY stated that the State's current funding policy is to reach 100% within 25 years. Most systems are on a path to amortize their unfunded liability over a period within GASB guidelines, which state a maximum 30-year period. If the target funding percentage is less than 100%, the amount of the contributions would be reduced initially. But a delay in payment of the unfunded liability means it grows with interest, so it becomes a pay-me-now or pay-me-later proposition. For accounting purposes under GASB, the funding target must be 100%, and the time period cannot be greater than 30 years. For funding purposes, the Board has discretion to set a rate that targets a lower funding ratio, but it increases the long-term cost to the plan. Buck would not recommend such a policy because by delaying the payment of the unfunded liability it is passing that debt on from one generation to another. Buck believes the Board has to have a plan to fully pay for the unfunded liability at some point in time. An ongoing plan can operate at a funded ratio less than 100% and do so in perpetuity, but it is a more costly way to fund the benefits.

CHAIR SCHUBERT called a short break from 2:42 to 2:55 p.m., after which Buck Consultants continued the Question and Answer part of their presentation.

11. Review in depth the exhibit: "Projected Impact of PERS Cost Sharing Plan" in the Teal/Baker presentation of April 27 and specifically answer - of the $6.6 billion employer

boost on DC employees, how much is for municipalities and what is the State portion?

MR. SLISHINSKY stated that Buck has a projection of this amount but has not completed it by employer. The State's payroll is 49% of the total, so all other employers are 51% of the total. By applying that to the $6.6 billion contribution, Buck estimates that $3.2 billion would be paid by the State and $3.4 billion would be paid by other employers. That assumes that it is a cost-sharing plan and all the employers are paying the same rate.

12. What are the funding ratios for PERS and TRS, going back 10 years, exclusive of health care, so we can compare our system to other systems?

MR. SLISHINSKY stated that going back to 1997 the PERS funding ratio (without health care) would be 146%, dropping down to 121% by 2002, and currently it would be 112%. The TRS funding ratio was 114% in 1997, dropping down to 93% by 2002, and currently it would be 85%.

MR. SHIER asked if there was any relationship between the maturity of the PERS and TRS plans and the last two graphs. MR. SLISHINSKY replied that generally the funded ratios for mature plans are likely to be less, based upon the economic period that we've gone through. Investment losses have affected the funded ratios of mature plans more so than less mature plans.

13. The health care funds apparently were not in a separate trust, yet at the March 2006 presentation a calculation was presented on pension funded health care. How were you able to calculate these if the funds were commingled?

MR. HULLA stated that there is no separate calculation of assets; it is purely the historical asset allocation that has been performed and that been reflected in the Comprehensive Annual Financial Report (CAFR), and that is what Buck's exhibits continue to reflect. If and when there is resolution at the IRS as to officially separating the assets going forward, that would change the whole picture.

MR. HULLA referred to a chart showing how the assets have historically been allocated, not separated. For TRS, the June 30, 2006 beginning year assets and activity, cash flow, etc. flowing through to year end, based on the June 30, 2003 valuation results, health care was 28.18% of the total. So the allocation methodology is to simply take 28.18% of the activity to the beginning year health care assets and flow them through to year end in that manner. He noted that Buck also provided for illustration purposes what they believe the funded ratios for pension and health care will be after going back and reconstructing that historic cash flow — and assuming that the IRS concludes that is where assets should be allocated. So for PERS, the current funded ratios of 78% for pension and 43% for health care would increase to 100% for pension but drop to 15% for health care. For TRS, the current funded ratios of 68% for pension and 36% for health care would increase to 80% for pension and drop to 11% for health care.

MR. HULLA responded to questions from MR. TRIVETTE and MS. HARBO about how Buck calculated the 28.18% allocated to TRS health care in the June 30, 2003 valuation. He said Buck's understanding is that the allocation has been based on the relative liabilities for pension and health care.

MS. HARBO said she has been trying for a long time to get the answer to who decided what percentage of the employer contributions coming in would go to the pension allocation and what percentage would go to the health care allocation. MR. HULLA noted that in 1976 there was a different asset allocation than now, so there would be a different health care contribution pattern. Buck has done their best to recreate that, and given the increases in health care costs, etc. it is what is driving a much lower funded ratio for health care versus pension. But that was not, in fact, the process. There was an allocation instead of segregated contributions and segregated activity, and that allocation is redone each year based on the actual liability results from three years prior. There are many factors in the divergent results.

MR. SLISHINSKY said that the way that it is being done now is not the way that Buck would typically allocate assets and carry forward assets from one year to the next. Buck would identify the cash flow (the contributions and the benefit payments) by fund — which are dedicated to pension and which are dedicated to health care — and then allocate expenses and investment return on some relative value of the assets in order to roll forward the asset amounts from one year to the next.

Referring to material on TRS covered earlier in the afternoon, MR. SLISHINSKY said that based upon the current valuation, health care is about 33% of the TRS actuarial accrued liability, so up a little bit from the 28.18% in 2003.

14. In the past, Mercer provided two funding ratios - one for non-medical benefits and one for total benefits. That was apparently calculated by adding health care assets to the pension assets and dividing by the pension liability only. Is this a correct procedure? Does it give a skewed or more "rosy" picture to the funded status than is actual? In the future, will Buck present the assets and liabilities with pension only, health, and then total?

MR. SLISHINSKY said that historically the funded ratio for non-medical benefits has been shown by using all assets for pension liabilities, as was done in question 12. However, this method overstates the pension funding ratios, since some of the assets were funded to provide health care liabilities. So there really are cash flows imbedded in the assets that include contributions for health care and also distributions that were made for health care. It is a mixed bag with regards to the assets. The June 30, 2006 valuations have been completed showing the pension and health care separately, based upon assets disclosed in the CAFR, and that disclosure is the way in which those assets have been rolled forward that was based on the 28% in 2003, applying that to the cash flow and the investment return to come up with the assets for the CAFR.

MS. HARBO remarked that the funding ratios shown in question 12 really were not true funding ratios exclusive of health care because Buck has added the health care assets and the pension assets together and divided just by pension liabilities. So if she wanted to compare Alaska's system to the California system funded ratio of 83% (where health care is decided on an individual location), this would not do it.

MR. SLISHINSKY agreed, saying that Alaska's pension assets would be different. He added that from Buck's reconstruction project they know that there are some assets for health care included in the total. If the State had not had the health care valuations as part of the whole process and included the contributions and disbursements for health care, then it would have been a different picture. So he did not think it would be accurate to look at this and say that Alaska is comparable to other systems that have not funded health care. He said that hopefully the State can get assets in separate trusts that the IRS approves of and can go forward from there with separate funding for pension and health care to get accurate recording of the funded ratios.

15. When health care assets are calculated, are assets from the dental/vision/audio and/or long-term care accounts included? If so, why, since they are entirely member-funded and have no employer contributions?

MR. HULLA stated that dental/vision/audio and long-term care assets are not part of any Buck valuation results. The Retiree Health Fund accepts contributions from the trust as determined for health care purposes and pays out the health care claims, and the fund is also a conduit for the dental/vision/audio and long-term care member contributions and payment of those benefits. When the Retiree Health Fund has been overfunded, money has been sent back to the pension side.

MS. HARBO said she understood that just the medical portion of the Retiree Health Fund was transferred back to the pension systems when it was overfunded, but not the dental/vision/audio and long-term care portion.

MR. HULLA explained that Buck's calculations have taken out the liability for dental/vision/audio and long-term care and worked with what was left.

MR. SHIER said that there is separate accounting for dental/vision/audio and long-term care assets, even though these member contributions are in the Retiree Health Fund.

16. Will the Board still be able to request that dollars in the medical health reserve account which exceed 15%-20% of anticipated claims for a respective year be transferred back proportionately to the four pension systems?

MR. SHIER stated that once there is a separate health trust the State will no longer be able to send assets back to the pension pool. The health care assets will be truly segregated.

17. Is it correct that using separate mortality computations for PERS and TRS will further lower the TRS funding ratio because teachers tend to live longer?

MR. SLISHINSKY said it is important to use the right mortality table for the group that is being valued in order to get a true funded ratio. PERS, peace officers, fire fighters and all others, and teachers have different expected mortalities. Teachers do tend to live longer than the general population. Using some blended table that takes into consideration experience for both PERS and TRS would give an inaccurate picture of the true funded ratio of each of those different plans. Using a lower mortality rate increases liabilities, which would then reduce the funding ratio.

18. How can the Legislature choose to call the defined benefit system closed for hiring purposes but open for contributions from employers of defined contribution employees? Since employers pay the same rate for all employees, do they save any money, or is it used up by additional administrative costs?

MR. SLISHINSKY stated that for funding purposes the population used for calculating the contribution rates can be different than the members earning the benefits. Contributions are first calculated as a dollar amount and then converted to a rate. The focus for any valuation is funding the amount of the contribution, which is the sum of the cost of the accruing benefits for the active members (the normal cost) and the amortization payment to pay for the unfunded liability. That is the dollar amount. That can be converted to a percentage of pay that is either the defined benefit payroll or total payroll, as long as when the rate is applied it is to that same payroll. If the system was closed for contributions, a higher rate would be applied to a smaller payroll base.

Regarding the second part of the question, MR. SLISHINSKY said that if employers are paying the entire cost and the State is paying none, there is no savings. As discussed in question 3, the lower percentage of pay amortization method means smaller payments now but larger payments in total. There are two important principles to recognize when paying for unfunded liabilities: one is pay me now or pay me later (because it is an amortization schedule of payments); and the less you pay today, the more you will pay tomorrow — but you'll pay more because you'll be paying that amount plus paying interest. Finally, Buck does not see any significance difference in administrative costs in paying the contribution over the defined benefit-only payroll versus total payroll.

19. Please list the number of members in each tier.

MR. SLISHINSKY said Buck provided that information on page 33 of the Question and Answer slides.

MR. PIHL asked what deferred vested members were. MR. SLISHINSKY said they are vested, have terminated service, and are eligible for future pension payments but have not reached eligibility to commence benefits yet.

20. Can you comment on ways to further reduce health care costs? A previous health committee of the PERS and TRS boards suggested a disease management program. Can you comment

on savings realized by a disease management program once it is implemented?

MR. HULLA indicated that Buck Consultants had brought copies of a nine-page paper entitled "Employee Health and Productivity Management" that goes into more detail on this entire area. The paper is active-employee focused, but that is intentional because Buck believes there is an important link to be leveraged in terms of managing the active health population in order to reduce long-term retiree health population costs. There is another document, "Leading By Example," published by the Partnership For Prevention. Many of the points covered today are included in both these documents.

MR. HULLA stated that there are generally four cost-reduction strategies for retiree health care:

A. Most employers can increase retiree out-of-pocket costs (increase the deductible, increase the prescription copay, etc.). That does not necessarily reduce total costs but it shifts costs away from the plan. That avenue is restricted under the contract law interpretation for Alaska.

B. Increase retiree pay premiums. As opposed to shifting costs through a deductible for each service rendered, shift costs by changing the share that retirees pay in their premiums. A very common strategy, but again, very limited in the case of the State of Alaska. There certainly are premium increases, but those are part of the current structure of those under age 60 paying their full freight, as opposed to the entire population changing from that share being, for example, 10% to making it something like 20%.

C. Improve provider discounts and the effectiveness of the management of care that health care networks do as their business. In the State of Alaska's case, that analysis is done net of fees. Effective July 1, 2006, the State switched from Aetna to Premera as third party administrator. A big part of that switch was an analysis of the lower net costs of the provider charges based on the various discounts, etc., as well as the care management programs that Premera put forth as opposed to Aetna. So that step has already been taken, and Buck expects to see lower costs than what might have been under the Aetna network.

D. Manage the population health to try and keep the overall costs down.

CHAIR SCHUBERT asked if point 3 included preferred provider arrangements, say with Providence Hospital in Anchorage or any other hospitals. MR. HULLA said a preferred provider arrangement would be an example of discounts. One network might have greater discounts at the hospitals that the State's population uses versus another.

MS. HARBO said that a few years ago Providence was not a preferred provider for retirees, yet 80% of the retirees in Anchorage used Providence. She asked Division of Retirement and Benefits staff if Providence was a preferred provider now.

MS. MILLER explained that while the active employee plan does have a provision that requires the use of Providence as the preferred provider organization in the Municipality of Anchorage, the retiree plan has no such provision. The retirees are unrestricted: they could go to Alaska Regional Hospital if they wanted, or they could go to Providence if they wanted. If retirees go to Providence, they do realize the savings that are built into the plan.

CHAIR SCHUBERT asked if that could be changed. MS. MILLER said potentially it could. She added that it is called a passive PPO (preferred provider organization) at the moment.

MR. TRIVETTE said he recalled there being talk about it in years past, but he was not aware that there was a passive PPO arrangement at Providence. He said there is a definite need for some education — because if he, as the president of Retired Public Employees of Alaska, doesn't know about it, then he assumes that a lot of the members do not know about it either.

MS. MILLER stated that the Division has created a new Health Matters newsletter that goes out to all the retirees and active employees. She said they would be happy to include that information in the next edition. Any of the providers that are participating in the network that the State is using because of the contract with the third party administrator, those discounts are available to all the members. Only the active plan has the provision that members have to go to a preferred provider organization when visiting a hospital in either the Municipality of Anchorage or in the rest of the United States.

MR. RICHARDS said he appreciated Buck's nine-page paper because he belongs to the Health Care Committee for the Fairbanks North Star Borough School District, and they spent about six years answering this question. They just finished the first year of a change to the health care plan. They had a health care cost increase of between 12%-14% over the last three to five years. Their goal was to cut that to a 6% increase a year in health care costs, but at the end of the first year they have seen a decrease of 6%. So there are many things that are very effective in reducing costs, and it might be to improve the overall health of the retirement population.

MR. HULLA stated that the most fundamental and most lasting approach to managing costs is to improve the overall health of the population. He congratulated Mr. Richards for the immediate return on his organization's plan. He said if the State were to undertake a health management program Buck would recommend taking a longer-term perspective in realizing some of the savings because commitment is what pays off in this arena.

MR. HULLA reviewed proven methods to improve active population health and produce real positive return on investment. Wellness programs — and the keys are target, incentivize, and monitor. Target means figure out what the conditions are in the State's population that can lead to additional health care costs and that can be managed, and then design a program around addressing those conditions. Incentivize - unfortunately, improved personal health has not proven to be enough incentive for people to maintain their health. So successful programs typically add some form of incentive. Monitor - it does no good to establish any of these programs if they are just put into place and forgotten about. The programs have to have goals in mind, methods of reaching those goals, and constant monitoring to see how goals are or are not being met, how the incentives are or are not working, and what can be done to improve them. There is plenty of jargon in the industry: wellness predictive modeling, health promotions (instead of wellness), population health risk assessment (instead of predictive modeling), etc.

MR. HULLA reviewed predictive modeling, which is outreach before symptoms escalate, and it is all based around building a sufficient claims database to be able to comb through it and look for individuals who are likely to generate large claims in the future and getting to them with educational material so they get into treatment before the costs escalate. Health coaching is another avenue of addressing that.

MR. HULLA described disease management, which focuses on the people who are actually in a hypertension situation or obesity, etc., where they are already exhibiting symptoms and generating costs. Disease management is extra support through education materials, health coaches, and protocols that can be established to improve the overall outcome and ultimately reduce the costs.

MR. HULLA said case management is further in the extreme of health care, dealing with patients in very high cost conditions. Case management, nurses typically, will likely go to a hospital where a person is an inpatient and negotiate a case rate in advance, instead of just paying the normal fees as they pile up.

MS. HARBO stated that there are about five diseases that really contribute to the health care costs for retirees in Alaska, but one of the most prominent ones is diabetes. She asked what the cost savings would be after the initial investment of setting up a disease management program for diabetes. She said she has heard the cost savings is about four times.

MR. HULLA said the savings vary by population. That is where building a database to be able to first confirm that diabetes might be the first condition to go after comes in, but also to measure the historic costs for diabetes in Alaska's population, in order to have the right baseline to be able to measure a return on investment in a program. The database also provides information on who to work with in a program and how to get the incentives to work. He guessed the return on investment for a diabetes program would be three or four to one - in an active population, because that is where most of the statistics are from.

MS. HARBO mentioned that she frequently hears a statistic that about 8% of the insured people are responsible for 80% of the cost to a health care system. She guessed a lot of those people would have diabetes, which could also affect heart conditions and stroke, etc.

MR. HULLA said the case management will address the people with super catastrophic conditions, where if left without any "case management" the bills would total $700,000, but with case management the negotiation could be successful at $400,000. And that is just one patient in one six-month period, for example. Case management is the lowest hanging fruit. Then disease management. Many, many employers have made the investment and are monitoring the health population, combing the data constantly to even get to the point of avoiding where someone is diabetic in the first place. Longer term, that is where the real value is, because then the system has saved all those costs, let alone reduced the costs once symptoms are there. And in an active employee setting, productivity has been increased.

MR. WILLIAMS stated that when the ARM Board was first created, and people were not sure who had responsibility for what, the Board created a Health Care Committee, which he chaired for all of one meeting. It was then determined that health care was the plan administrator's responsibility and not this Board's. The Health Care Committee discussed issues similar to this in depth with the Division of Retirement and Benefits almost two years ago. He understood the plan administrator was well on the path to addressing all these techniques and doing everything in their power to control health care costs. For that reason, he asked that further discussion be limited to five more minutes.

COMMISSIONER KREITZER said she intended to add an item to tomorrow's agenda to discuss resurrecting the ARMB Health Care Subcommittee that could provide a forum to talk about some of these issues.

CHAIR SCHUBERT asked Buck Consultants to move on to question 21.

21. In your opinion, what has the Board done right to reduce the unfunded liability, and what, if any, additional steps can we take to make the process better, to reduce costs, and to present information to give a clear picture of the status of the Funds?

MR. SLISHINSKY stated that in the time that Buck has been working with the ARM Board, it adopted the new assumptions and the new cost method last year, as well as adopting the full actuarial contribution rate, and it took a lot of guts to take that difficult step. The Board certainly followed the actuary's recommendations. The Board is thinking about its fiduciary responsibilities in making those decisions.

MR. SLISHINSKY said that additional steps would include on the pension side (and maybe on the health care side) reducing the two-year lag in implementing the contribution rates. That was discussed earlier today, and Buck has talked about it with staff for several months. It is a step that will make the funding of the plans more accurate and clearer. Other steps would be to adopt and monitor cost-saving measures to control health care claims (as described in question 20); calculate and disclose rates and assets for pension and health care separately (talked about earlier); and calculate and disclose rates by tier, which provides more information (covered in question 5).

MR. SEMMENS asked, if rates stabilize or if rates begin to decline because payroll increases, if the two-year lag would continue to be of great concern. MR. SLISHINSKY replied that one could paint a picture where there is less concern, but in the plans that Buck deals with they don't see a two-year lag. The lag presents the potential, and has over the last few years resulted in contribution amounts that did not meet what was actuarially calculated, as a result of applying lower rates in a two-year delay to years where higher rates were being calculated in those actuarial valuations. He said it is important to apply a rate for a particular year based upon the situation in that year and then the year after.

22. Since the last actuarial audit was done in 2002, when should the next audit take place?

MR. SLISHINSKY explained that the 2002 audit was a limited scope audit done by Milliman. Gabriel Roeder Smith & Company, the State's second actuary, is doing a limited scope audit on an annual basis. When Buck Consultants took over the actuarial work they did a full replication of the Mercer numbers in 2004 and disclosed those differences to the Board. There are statutory requirements to have audits done at least once every four years. When applying that section of the statute, it would be a good idea to do a full replication at that time.

MR. SHIER asked if a full replication as of June 30, 2004 was the same thing as a full scope audit. MR. SLISHINSKY responded that a replication is taking the data and getting the numbers. A full scope audit is doing more than just the replication, but it is possible to do a limited scope audit without doing the replication. So the auditor is looking at the reasonableness of the assumptions and looking at the big picture, and not just replicating the numbers that come out of an actuarial valuation report.

23. Information request: It is apparent from comments made at our recent meetings that there is recent information from the actuaries that has not been shared with the ARM Board. We have received copies of some correspondence but not others. For example, the letter to Retirement and Benefits on the comparison costs of the various tiers was obtained at a legislative hearing, not through the ARM Board. Mr. Teal made it clear that he was asking questions and getting information from the actuary. Since the ARM Board is responsible as fiduciary for the trust funds, please have Buck and Gabriel Roeder Smith provide the Board with copies of all correspondence (including e-mails with information and data) and monthly bills since our meeting last November.

MR. SLISHINSKY stated that Buck supplied all the requested information. There was a lot of correspondence from January through April 2007 on legislative issues that were going on at the time.

MR. TRIVETTE said that in reviewing the bills from Buck Consulting it looked like there were two separate contracts. MR. SLISHINSKY explained that there is one contract for the actuarial work that includes the valuations of pensions and health care, and then there is a separate contract for Mr. Hulla to provide benefit consulting.

MR. TRIVETTE observed that the bills totaled about $758,000 over ten months. He said he noted there were issues regarding active premium equivalents, etc. He wanted to make sure that retirement money, of which the ARM Board is the fiduciary, was not being spent for current employee issues.

He also said he appreciated seeing the memorandums that Buck provided because it gave him as a trustee some idea of the things the actuary is dealing with, probably a larger scope of information than the previous actuary had. He asked if all the other requests of Buck over the last fiscal year had made it hard for them to get the reports out on time. He recalled that the actuarial valuation reports used to be issued in March every year.

MR. SLISHINSKY replied that the delays in the reports were primarily from the changes that have been required this year — changing the assumptions, changing the cost method, and certainly going through the calculations for GASB 43 and 45. Some of the delay in producing the reports was just waiting for decisions. To the extent that there are fewer changes on the accounting side or statutory changes in the future, the process should go more quickly.

DISCUSSION OF RESOLUTION 2007-20 - FY08 PERS CONTRIBUTION RATE

CHAIR SCHUBERT stated that Resolution 2007-20 directed the Division of Retirement and Benefits to notify Public Employees' Retirement System (PERS) employers that their contribution rate will be set at 22% of payroll, but not lower than 14.48%, consistent with the rates set in the June 30, 2005 Buck Consultants PERS Supplement to the Actuarial Valuation Report.

COMMISSIONER KREITZER explained that with Resolutions 2007-20 and 2007-21 the Department of Administration was trying to articulate as simply as possible what happened regarding employer contribution rates, recognizing that this was a one-year solution that the Legislature ended up with. She said she understood that Mr. Semmens had concerns about some of the language that sets out the PERS employer contribution rate for FY08, and that she was happy to hear recommendations from others on what they thought the appropriate rate should be.

MR. WILLIAMS said he had a legal question about the Board's directive under AS 39.35, which is to set the employer contribution rates and certify to each employer about the normal cost and the rate required to pay off the unfunded liability. He wondered how to reconcile that statutory requirement with the intent language of SB 53, which may or may not have any statutory weight behind it. He said that was what he was struggling with.

MR. BARNHILL stated that the key is the word "effective" that was inserted into the intent language at Mr. Shier's suggestion, in recognition that the full actuarial contribution rate is different this year than the effective rate employers will be paying because of the additional appropriations. So the resolution says the Board is setting the "effective" rate, the rate that the employers will actually pay from their accounts because the Legislature is contributing the difference.

MR. SEMMENS read the part of the resolution that caused him concern: "WHEREAS, it is the Legislature's intent in Senate Bill 53 that the appropriated $185,000,000 is the amount required to set the effective employer contribution rate of all PERS employers for FY08, as indicated in the June 30, 2005 Buck Consultants PERS Supplement to the Actuarial Valuation Report, at the lower of the level percentage of pay rate approved by the ARMB or 22 percent, but not lower than 14.48 percent;" He said the Board has not approved the PERS employer contribution rate at the lower of the level percentage of pay rate or 22%. The Board approved the rate at 39.76%, using the level dollar method. So he was concerned about there being language in a whereas clause that talks of something that the Board did not really do.

MR. SEMMENS said he did not have in front of him Resolution 2007-19, which the Board approved in support of Senate Bill 125, and which was referenced in the first whereas clause of this resolution. But he recalled that the "Now, Therefore" part of Resolution 2007-19 was along the lines of agreeing to lower the rate to 32.51%, which is the level percentage of pay rate. He said the resolution may have said something about 22% of payroll, but he did not recall that. So he was a little concerned with what Resolution 2007-20 was saying. However, he agreed with Commissioner Kreitzer's statement about trying to make the resolution language simple.

MR. SEMMENS said he was wrestling with whether or not to advance a Resolution 2007-20 substitute, which is significantly different and does not speak to SB 125 because that bill failed. Senate Bill 123 is the important bill here, because it allows the ARM Board to use the level percentage of pay basis. There were two motivating factors behind his wanting to amend the resolution. One was whether the ARMB wants to be on record setting the actual rate at 22%, significantly below the actuarially required rate in the PERS system, an agent multiple employer PERS plan whereby every single employer has a different rate and a different unfunded liability. If SB 125 had passed, he would not have this particular problem. It is rooted in whether or not employers will have a larger net pension obligation. After the Buck Consultants presentation today, it seems fairly clear that, from an accounting perspective, employers are going to have large net pension obligations because the accounting rules are going to require a level dollar calculation. There may be Board members who think the ARMB should stay with the level dollar method because it gets more money into the system. He said the question of the net pension obligation has become less important to him as a bean counter because employers will have to deal with it anyway. The whole question comes down to the whereases that he was not sure accurately reflect what the Board has done, and the question of whether or not the Board wants to set a rate that is significantly less than the actuarially required amount.

Acknowledging that this discussion was not about the Teachers' Retirement System, MR. SEMMENS said that system is a cost-share plan, and he thought there would be agreement to set the TRS rate at 12.56%. That is significantly below the actuarially required rate, whether that rate is 42% on the level percentage of pay method or 54% on the level dollar method. He would be okay with that because one plan is a cost-share plan and one is not.

MR. SEMMENS said his idea for the "Now, Therefore" part of the resolution was that the contribution would be based on Buck Consultants June 30, 2005 PERS Supplement to the Actuarial Valuation Report, and that the employer shall provide no more than 22 percent of payroll, but not less than 14.48 percent, and that any employer whose contribution rate is greater than 22% of payroll shall have the difference between the greater rate and 22% provided by the State. He said that since he came up with that language he thought of another problem that Mr. Teal alluded to earlier when he talked about a State supplemental. In the event that the $185 million is short, then the PERS system will not get funded at 32.51% average. Who would be responsible for the shortfall? For that reason, he would want to add one more "Be It Further Resolved" to his version of the resolution that clarifies that if an employer contributes 22% of their payroll then their obligation to the plan is satisfied. So should the State's calculations be wrong, the most likely result would be the system not being fully funded at 32.51%. The amount might not be significant, but the Legislature could choose to do a supplemental to bring it up to the full level percentage of pay.

MR. SEMMENS said he did not want to suggest changing the language of Resolution 2007-20 and have it result in his constituency being responsible for a greater amount of money than the flat 22% rate recommended by the Department of Administration.

MR. PIHL stated that he had run some numbers to check things. The Board is using Buck's June 30, 2005 PERS actuarial valuation report, and the payroll base in that report is $1,513,000,000. Taking 22% of that is $332,000,000. Adding the State's $185,000,000 appropriation results in a total of $518,000,000. Buck's 2005 report says the required contribution is $515,000,000, a very close match that provides some comfort. Those numbers do not account for the fact that some employers will be paying less than 22%. He wondered about the impact of that.

COMMISSIONER KREITZER said the more appropriate person to ask about how the Legislature came to the $185 million figure was David Teal from the Legislative Finance Division.

MR. TEAL told the Board that Legislative Finance's web site has a spreadsheet that explains how the $185 million appropriation for PERS was determined. The calculation started with a wage base of $1.7 billion, and there were later corrections after the Buck report came out, so the slightly higher wage base accounted for the small differences from Mr. Pihl's calculations. The grand total was that the ARM Board rate should generate $553 million, of which the employers would be paying $369 million, leaving $183.6 million to be paid by the State. That was simply rounded up to $185 million.

MR. PIHL suggested that perhaps Legislative Finance advanced the 2005 payroll base of $1,513,000,000 from the actuary's report by some percentage per year to arrive at a higher payroll base number for fiscal year 2008. He asked for a copy of the Legislative Finance spreadsheet for trustees to look at overnight.

In an effort to explain the $185 million figure and Mr. Semmens's mention of the possibility of a shortfall in FY08 employer contributions, MR. TEAL said that the collections and rates are based on a set of assumptions. One of those assumptions is that the wage base grows at 3%. For FY08, the assumption is a 3% growth from FY07, which was 3% higher than FY06. So it is getting to be old data. He used Fairbanks as an example, which has a contribution rate of 185%. Under the law passed, Fairbanks would be paying 22% of payroll for FY08, so the State will be paying many times what the city of Fairbanks pays. And if the State has under-estimated Fairbanks's payroll, or Fairbanks hires 15 more employees or gives people pay raises, there is a significant amount of State money that will be required to make that up. The State may or may not be short with the $185 million appropriation for PERS.

Regarding when the PERS system would receive the $185 million, MR. TEAL said the thinking was that because that money is available to the Department of Administration on July 1, 2007, there would be a big pot of interest earned on it that could be used to make up for any shortfalls if the wage base is higher than was estimated. He said he fully expected that when the numbers are final there would be a supplemental appropriation made by the Legislature to make the PERS system whole. He stressed that he can never speak for the Legislature, but he thought that was the way the Finance Committee members were looking at it — it is all estimates, we'll do the best we can and fix it later.

MR. RICHARDS mentioned that the Board has repeatedly heard that if there is a shortfall in full funding it will accumulate interest on the unfunded liability to worry about also. So if the contribution rate were set higher than 22% — and the number 32% was floating around but perhaps 25% or 26% — and if there was a bit more in contributions at the end of the fiscal year, then the Legislature would not have to come up with any more money, and the little bit extra from having set a higher rate could go towards paying down the unfunded liability. This is another way of handling it, rather than letting the Legislature deal with any potential shortfall.

MR. SEMMENS stated that the municipalities have already set their budgets. Although many of them are not clear because the ARM Board has not done its thing, he could guarantee that should the Board set a rate that causes employers to have effective rates higher than 22%, it would cause significant upheaval in municipal budgeting and people would be attending the next board meeting. He said he would not be in favor of setting the effective rate higher. His substitute resolution essentially sets the rate at an average of 32.51%, per the June 30, 2005 Buck Consultants PERS Supplement to the Actuarial Valuation Report. Then the substitute resolution says that the effective rate for employers is 22% or whatever it is in the Buck supplemental report, but not less than 14.48%. (There are employers who have contribution rates less than 14.48%, but the Legislature would like to see them pay at least 14.48%, which was the normal cost rate in the June 30, 2005 valuation.) Further, any difference would be made up by the State. Lastly, the substitute resolution would have a statement that employers will have satisfied their obligation to the plan if they pay 22%.

Addressing legal counsel, COMMISSIONER KREITZER proposed combining Resolution 2007-20 and Mr. Semmens's substitute with all the duplications stripped out so that it set the level percentage of pay rate as 32.51% with the caveat that if the funding is not available then the burden is on the State. She said she thought both pieces were necessary.

MR. BARNHILL stated that he and Virginia Ragle talked about this in advance of this meeting, and there is no legal problem with that approach. He added that under SB 123 he thought the ARM Board has to set separate rates for the medical and pension contributions.

MR. TRIVETTE commented that the substitute resolution that Mr. Semmens had presented covered all the bases, with the one statement he added at the end. He asked if there was a reason not to just go with that version of the resolution, as opposed to trying to put the two versions together.

MR. JOHNSON stated that there is no legal problem, and the choices of the two methods are appropriate, although there is the exercise of having to deal with the SB 123 requirement of portioning between the medical and pension. Regarding the substitute resolution, he pointed out that the "Be It Resolved" paragraphs that Mr. Semmens has suggested have to be limited to FY08. This is not a global fix for the rest of time. Finally, there should be a clause added to the last two "Be It Resolved" paragraphs that refers to if SB 53 is enacted into law. It has been passed by the Legislature, and there is every expectation that the Governor will sign the bill or allow it to become law. But if the Board is acting on the resolution today, there needs to be a little coverage piece on that.

CHAIR SCHUBERT requested that Mr. Johnson and Mr. Barnhill work on a merger of the two versions of Resolution 2007-20, based on the Board's discussion. For example, the original version contains reference to the Board's previous approval of Resolution 2007-19 in support of the State making an appropriation to the PERS system. She said that is not mentioned in Mr. Semmens's substitute resolution, and although it might be superfluous, it is kind of nice to have the whole history in one place. She asked if anyone objected to that direction to legal counsel.

COMMISSIONER KREITZER indicated that she preferred that the Board do the resolutions separately, because, although related, SB 123 was a separate issue (dealing with the calculation of the employer contribution rates on the full payroll of employees in both the defined benefit and defined contribution plans).

MR. TEAL mentioned the difference between the TRS approach and the PERS approach. He said the TRS resolution (2007-21) is very simple and, in his opinion, the most important one because it needs to be very clear that the TRS rate is set at 12.56%. The University's Optional Retirement Program rate depends on the rate set by the ARM Board. If the Board were to follow the TRS resolution for PERS, to be consistent it would say that the ARM Board sets the rate at 22%. He said he did not know that there was a need to be consistent, but that was a question for Mike Barnhill. It is a question of do we get sued because a bunch of Optional Retirement participants say, "The rate should be 54% and I want 54% of my salary deposited into my account. You guys are manipulating things here, the rate is not 12.56% no matter what you say it is." He said the TRS resolution is a nice simple approach.

CHAIR SCHUBERT said she had not brought up Resolution 2007-21 for discussion because she assumed that it was well drafted.

MR. BARNHILL stated that as legal counsel, he evaluated the Optional Retirement Program issue for the University. It was his view that this Board does not really have any oversight or purview over ORP issues. The ARMB does not have to set rates in recognition of what deal the University has. In recognition of the fact that the $270 million in additional contributions will come in (for TRS), assuming the appropriations are approved and enacted into law, the Board can set an effective rate of 12.56% for TRS. If the Board wants to go the extra mile and set the rate, as opposed to the effective rate of 12.56%, the Board would be doing so in recognition that there could potentially be a lawsuit and the Department of Law would defend that.

When queried by the Chair, MR. SEMMENS indicated that he was fine with combining the original version of Resolution 2007-20 with elements of his substitute resolution. He noted that his substitute does not set the contribution rate for PERS employers at 22%, but it makes it very clear that employers would not pay more than 22%. He thought that was the intent of SB 53.

COMMISSIONER KREITZER said she had earlier used the word "combine" and she apologized for that. She said Mr. Semmens's substitute resolution would have to go before Resolution 2007-20 because obviously it has not happened yet. Having worked with and followed the timing on SB 123 and SB 125 all through the legislative session, she had it in her mind that it wasn't an issue, because the PERS rate would have to be set first and then Resolution 2007-20 would happen second. That was fine with her.

A brief exchange took place among trustees and legal counsel about the order in which Board actions should occur in resolutions. MR. BARNHILL said he understood that Resolution 2007-20B (Commissioner Kreitzer's) would change the original resolution so it set the effective rate at 22% rather than setting the rate. He said if that is what it does, then the two resolutions would be complementary.

CHAIR SCHUBERT asked legal counsel to work this out and give the Board a new draft resolution for setting the FY08 PERS employer and state contribution rate in the morning.

MR. RICHARDS spoke in support of another legal counsel review so the Board could look at it again in the morning. He said he did not want the Board to make a mistake at the end of a long day.

MR. SEMMENS stated that inserting the words "effective rate" took care of the concerns that he had about first setting the PERS rate according to the actuarial report and then changing it to 22%.

MR. WILLIAMS mentioned that the fiscal year 2008 rates should be mentioned in the resolveds, according to Roberts Rules of Order.

TRUSTEE COMMENTS

MR. TRIVETTE thanked Mr. Teal for his help today.

MR. PIHL praised the Buck Consultants presentations for being well done and understandable to lay people.

CHAIR SCHUBERT said she echoed that, because dealing with actuarial information can be extremely dry and sometimes painful, but Mr. Slishinsky and Mr. Hulla did a good job of making it understandable and thorough.

RECESS

CHAIR SCHUBERT recessed the meeting for the day at 4:38 p.m.

Thursday, June 14, 2007

CALL TO ORDER

CHAIR GAIL SCHUBERT called the meeting of the Alaska Retirement Management Board back to order at 9:01 a.m.

ROLL CALL

CHAIR SCHUBERT noted that the roll call had been taken at the beginning of the meeting yesterday morning. Eight ARMB trustees were present Thursday morning to form a quorum.

ARMB Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Commissioner Annette Kreitzer
Martin Pihl
Tom Richards
Larry Semmens
Mike Williams

ARMB Board Member Absent
Commissioner Patrick Galvin

Investment Advisory Council Members Present
Dr. William Jennings
Dr. Jerrold Mitchell
George Wilson

Consultants Present
Robert Johnson, outside legal counsel
Mike Barnhill, Alaska Department of Law legal counsel
Michael O'Leary, Callan Associates, Inc.

Department of Revenue Staff Present
Brian Andrews, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Julie Pierce, State Comptroller
Bob Mitchell, Senior Investment Officer
Judy Hall, Board Liaison

Department of Administration Staff Present
Rachael Petro, Deputy Commissioner
Patrick Shier, Director, Division of Retirement and Benefits
Kathy Lea, Retirement and Benefits Manager

Invited Participants and Others Present
Glenn Carlson and Juan Benito, Brandes Investment Partners
Neil Tremblay, Dan Pierce and Peter Kashanek, State Street Global Advisors
Michael Fry and Tony Dote, Lazard Asset Management
Rob Gillam and Alex Slivka, McKinley Capital Management
Virginia Ragle, Department of Law (by teleconference)
Jack Kreinheder, SOA Office of Management & Budget
Chad Stiteler, Anchorage School District
David Teal, Legislative Finance
Alden Thern, Anchorage School District
Michelle Yerkes, Municipality of Anchorage
Toni Prockish, Municipality of Anchorage
Jay Dulany, Retired Public Employees of Alaska
Robert Ralls, Retired
Brook Ivy, Intern at McKinley Capital Management

PUBLIC MEETING NOTICE

The Chair stated that public meeting notice requirements were confirmed yesterday.

APPROVAL OF JUNE 14, 2007 AGENDA

MS. HARBO moved to approve the June 14, 2007 agenda. MR. SEMMENS seconded.

MR. BADER requested the addition of "Asset Allocation - Medical Trust Fund" as agenda item 16 under Reports on the agenda.

COMMISSIONER KREITZER asked to add "Health Care Committee" under New Business.

There was no objection to approving the agenda as amended.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

ROBERT RALLS, a retired PERS participant from Sterling, addressed the Board in person and also provided for the record his written comments about preventive retiree medical benefits *(on file at the ARMB offices)*. He said that currently the retiree medical benefits will only allow catastrophic coverage for retired state workers, and he was advocating for the benefits being updated from catastrophic to preventive care. Under preventive care coverage retirees could get annual physicals and other benefits not available under the catastrophic system. He described his late wife's illness and eventual death from cancer in 2000. He also described how retirees and dependents have to pay for a colonoscopy out of pocket if it is the first screening, when colon cancer tops the list of leading cancer deaths. He said the State would save money by switching from catastrophic to preventive medical coverage for State retirees who are living on a fixed income.

MR. WILLIAMS asked that Mr. Ralls's comments be referred to the Division of Retirement and Benefits for any necessary follow-up.

MR. RALLS said he had already done that.

COMMISSIONER KREITZER thanked Mr. Ralls for appearing and offering his comments. She mentioned that she was going to ask for a Health Care Committee of the Board to vet concerns about coverage, etc., with assistance from the third party administrator, Premera. That way coverage decisions could be made on a sound, scientific basis and not in an emotional environment. Regarding colorectal screening, there is an advantage to getting a screening at a younger age, so there is the question of whether the State through the active plan should have folks try to get that accomplished at a more appropriate age.

MR. RALLS stated that normally people retire when they are 60, and there is a gap between age 60 and 65, when Medicare takes over. He thought that was a critical five years in somebody's life. He said there has to be a system that benefits the retirees, and people are living a lot longer.

CHAIR SCHUBERT thanked Mr. Ralls for his comments.

JAY DELANEY introduced himself as a PERS retiree and Vice President of the Retired Public Employees of Alaska. He said the organization stands ready to assist the ARM Board with its tasks in any way possible.

APPROVAL OF MINUTES - April 26-27, 2007 and May 2, 2007

MS. HARBO moved to approve the minutes of the April 26-27, 2007 ARMB meeting. MR. SEMMENS seconded.

MR. WILLIAMS asked that the short paragraph near the end of page 40, beginning "There was a brief exchange between..." be struck from the minutes. He said it was a sidebar exchange on parliamentary procedure and had no bearing on the discussion or effect on the vote.

The minutes were unanimously approved as amended.

MR. SEMMENS moved to approve the minutes of the May 2, 2007 ARMB meeting. MR.

WILLIAMS seconded. The motion carried unanimously.

REPORTS

1. Chair Report

CHAIR SCHUBERT drew attention to a May 31, 2007 letter in the packet from Gary Bader, chief investment officer, responding to her inquiry about guidelines for trustee travel to conferences, seminars and manager oversight visits. She said she had discussions on a number of topics with staff since the last meeting, and Mr. Bader would cover some of those discussions in his report.

2. Chief Investment Officer Report

MR. BADER reported on the following items:

- A letter from Robert Gillam, President of the Gillam Foundation and also the head of McKinley Capital Management, a firm that invests approximately $600 million on behalf of the ARM Board. The Gillam Foundation has been making scholarship awards to Alaska students who show an inclination to some form of entrepreneurship when they go on to college. At up to $10,000 each, this is one of the top scholarships awarded to Alaska students. Mr. Bader has been sitting on a review committee for the Gillam Foundation to review student applications. He said it is important to bring to the Board's attention that its investment managers are not only doing a good job investing money on behalf of the participants in the various State retirement systems, but in this instance returning some of their profits to the State of Alaska.

CHAIR SCHUBERT stated that she also participates in the Gillam Foundation scholarship evaluations.

- There were a series of notifications of proxy votes in the board meeting packet. The Treasury Division investment staff manage an internal real estate investment trust (REIT) investment program and vote the proxies of the various REITs in the portfolio. The Board has a policy that requires an investment manager to report if they have 3% or more of their ARMB portfolio invested in any one company. These notifications are thus required because by and large the only REIT investments the ARMB has are the ones made by staff.
- A report from RCM about their proxy vote on AT&T.
- Notification that the CIO transferred $500,000 from Capital Guardian International to Fixed Income, as provided by Board policy, to provide liquidity to the system.
- Notification that the CIO transferred $800,000 from Russell 1000 Growth investments to Fixed Income.
- A letter dated April 13, 2007 regarding the Nebraska ban on corporate farming being lifted. There have been prohibitions on institutional investment in farmlands in many of the

Midwest states, Nebraska being one of them. The intent of the law was to protect the family farm and prevent institutional ownership of these parcels. The case eventually went to the U.S. Supreme Court, and the letter provides the details of the Court decision. The ARM Board has a farmland portfolio but has not made investments in the Midwest up until this court case. The ARMB now has one investment in the Midwest in a previously prohibited state. Staff will provide a report on the farmland holdings at the September meeting.

- At the last meeting, the Board approved the termination of three investment managers and directed staff to invest those assets otherwise. The transition out of TCW small cap has taken place, and those monies are entirely invested in the Russell 2000 Value Fund. This will go a long way toward balancing the holdings between growth and value managers in that asset class. The contracts with Quantitative Management Associates (QMA) and Barrow, Hanley & Associates, Inc. are in progress. Through those investment actions, staff expects an estimated $1.6 million savings of investment management fees per year. In addition, the hope is that the portfolio will perform very well.

3. Committee Reports

A. Audit Committee

Committee Chair LARRY SEMMENS reported that the Audit Committee met June 12 and received presentations from the independent auditor, KPMG; Julie Pierce, the State Comptroller from the Department of Revenue; and Rob Johnson, the Board's outside legal counsel. At Mr. Johnson's suggestion, the Committee made a recommendation that the ARM Board schedule a review session for ethics and disclosure at a future meeting. MR. SEMMENS asked staff to provide all trustees with a copy of the June 12 Audit Committee meeting minutes.

B. Defined Contribution Plan Committee

Committee Chair SAM TRIVETTE reported that the Defined Contribution Plan Committee (Williams, Richards & Trivette) met June 12 to look at the whole issue of the default investment option for the defined contribution plan. The Committee reviewed and approved the charter of the committee, and it reviewed the work that had been done by the Alaska State Pension Investment Board, as well as what this Board had done previously. The Committee set out a framework for completing its task and intends to bring a final recommendation to the full Board at the November meeting. MR. TRIVETTE asked staff to provide all trustees with a copy of the June 12 Defined Contribution Plan Committee meeting minutes.

4. Legislative Update

COMMISSIONER KREITZER said the Department of Administration (DOA) was committed to making sure that the Board gets the paperwork that is generated during a legislative session. Some of the information requested from the actuary during the last session was used and some was not, and there was a lot of correspondence flying back and forth. She asked her fellow trustees to think about whether they would prefer to have everything that is generated or only the items that the Department of Administration actually uses to make decisions.

COMMISSIONER KREITZER stated that Senate Bill 123 is the "technical fix" bill that allows the employer rate to be spread across the defined benefit and defined contribution employee payrolls. The Governor signed that bill in Fairbanks last week. Senate Bill 125, which would have created the cost-share plan for PERS is sitting in the Senate awaiting concurrence in House amendments. It is feasible that the Senate could just take up concurrence or that the Legislature could start the discussion all over again. The DOA will track the status of SB 125 and keep the Board updated. Finally, as a one-year fix, the Legislature appropriated money into the PERS and TRS systems as partial payment of the employer contribution for FY08. The Legislature was concerned with tying together revenue sharing aid to local governments and PERS and TRS and education funding. So in the end, when education funding became a sticking point, the solution was to provide enough funding to make the effective rate 22% for most PERS employers and 12.56% for the University and school districts. During the interim, the Departments of Administration and Revenue will work to see if the cost-sharing plan continues to make the most sense. House Bill 13, the pension obligation bond bill, is sitting in Senate Finance.

MS. HARBO asked if July 1, 2006 through June 30, 2007 was the only year in which employers just made contributions for defined benefit employees, and that after SB 123 passed, the employer contributions would be for both defined benefit plan and defined contribution plan employees, without anything being retroactive. COMMISSIONER KREITZER acknowledged that the change occurs July 1, 2007.

5. Fund Financial Report

MS. PIERCE reported that for total funds under the fiduciary responsibility of the ARM Board the Schedule of Investment Income and Changes in Invested Assets reflects investment income of $2.5 billion and net withdrawals of $422 million year-to-date, and investment income of $452 million month-to-date and net withdrawals of $35 million. The ending investment asset balance at April 30, 2007 was $18.4 billion. She indicated that the financial report also included several pages of more detailed data for the four defined benefit plans — PERS, TRS, Judicial, and Military. There was also a Schedule of Investment Income and Changes in Invested Assets showing activity by manager for the defined benefit plans, and a similar schedule for the participant-directed plans.

MR. PIHL asked if Ms. Pierce worked something out with the Division of Retirement and Benefits so the Board can get a breakout of the contributions and withdrawals. MS. PIERCE replied that she had talked with Christina Maiquis, an accountant in the Division of Retirement and Benefits, but was waiting to further that conversation until the Division's new chief financial officer was in place.

MR. PIHL said the netted number of contributions and withdrawals has been negative and is an alarming thing that the Board has to watch.

6. Fund Performance Review - Quarter Ending March 31, 2007

The ARM Board's general consultant, MICHAEL O'LEARY of Callan Associates, spent the next hour reviewing the investment performance of the retirement fund for the periods ending March 31, 2007. *[A summary of Callan's detailed presentation material, dated May 2007, is on file at the ARMB offices.]*

MR. O'LEARY stated that the quarter ended 3/31/07 was a great quarter, as was the trailing 12 months. He informed the Board that the numbers in the Callan material were preliminary in that they included the preliminary real estate numbers. The final real estate numbers subsequently came in and Callan submitted the updated report.

MR. O'LEARY compared the Treasury yield curve at 3/31/06, at 12/31/06 and at 3/31/07, showing that interest rates at the shorter end of the curve were much lower in early 2007, and there was not a significant change at the longer end of the curve. But since the end of March interest rates in the U.S. and a number of major markets have risen dramatically, and that is significant news. It has not been accompanied by a change in Federal Reserve policy.

MR. O'LEARY mentioned Callan's standard comparison of stock and bond returns. The first quarter of 2007 saw a return of market volatility, and the stock market didn't do much, while the bond market had a positive return. Subsequent to quarter end, that positive return in the bond market has gone away. April and May were very good months for the stock market, while June has been "challenged."

International stocks have continued to do very well compared to domestic stocks. This is important for the Board because the Fund's slight overallocation to international stocks relative to the policy target has contributed to strong Fund performance.

Fiscal year-to-date, large cap stocks have done better than small cap stocks, despite the fact that during the March quarter small cap outperformed large cap. Over the trailing 12 months, large cap stocks have had remarkably better returns than small cap. But over longer periods up to 10 years, small cap stocks have done better.

While the value equity style has outperformed the growth style over all the longer-term measurement periods, in the March quarter their returns were essentially equal.

MR. O'LEARY reviewed the asset allocation for the PERS and TRS portfolios. He noted that the illiquid asset categories were very close to targets: real estate at the end of the March quarter was at 11.0% versus the target of 10.0%; private equity was at 6.6% versus the target of 7.0%; and other was at 1.1% versus the target of 3.0%. Other is the category that includes energy investments, farmland, and TIPS. Absolute return was very close to the target allocation. International equity was 19.2% of the whole portfolio versus the target of 16.0%. Contrasted to other public funds, the

ARMB's Fund is widely diversified in every major asset category. It has greater exposure to alternative investments, fairly high real estate exposure, and comparatively low domestic fixed income exposure. So the fact that interest rates went up a lot subsequent to the end of March should be less of a concern for the ARMB in many respects than for other public funds.

Looking at charts of the total Fund performance attribution analysis, MR. O'LEARY gave updated numbers: PERS returned 2.99% for the quarter, and TRS earned 3.0%, while the real estate component's final number was 4.6%. Both PERS and TRS had very strong performance relative to target, and each asset category delivered better than target results (other than the Other category). PERS returned 13.37% and TRS earned 13.39% for the trailing 12 months, while the real estate component's final number was 22.37% for 12 months. He highlighted three results for the 12-month period as being extraordinary numbers — 22.37% for real estate, 20.53% for international equity, and 22.27% for private equity. He also reviewed trailing three-year and five-year results for PERS and TRS, both of which were very attractive relative to the target rates of return.

MR. O'LEARY presented the cumulative total Fund results compared to Callan's public fund database, for the quarter and one, two, three and five years. They are all attractive numbers to look at, and he complimented the work of the Treasury Division's investment staff and the Board's external managers. He said Mr. Bader deserves great credit for the results.

MR. O'LEARY said that cumulative results can give a distorted view because they are so influenced by the most recent results, so it is important to look at the individual calendar periods to get a good sense of perspective. While 2006 was a very strong year, the results in the other calendar years were very competitive as well. So he was pleased with the character of the performance pattern. Over 15-1/2 years, the PERS portfolio has a 9.35% long-term return relative to the target of 9.19%.

MR. O'LEARY next presented results for each of the major asset categories, as follows:

- The total fixed income pool has been managed against different benchmarks, was managed first internally, then internally and externally, and now internally. So the historic results are different than the results for the current in-house fixed income portfolio. The returns are consistently above the custom index.
- Total international equity performance was very strong for the quarter and fiscal year to date, and has been top quartile for the last three years when compared against other public funds. It has been above median and above the benchmark for the seven- and ten-year periods.
- The large capitalization domestic equity pool has done better than the large cap index (S&P 500) for the quarter, the fiscal year to date, and for the trailing 12 months. It is refreshing to see that change.
- The small cap domestic equity pool is above median for the fiscal year to date but a tad below the Russell 2000 benchmark, despite outperforming that handsomely during the March quarter.

MR. BADER pointed out that the Board gave staff authority to divide the S&P 500 allocation into

Russell 1000 Growth and Russell 1000 Value portfolios, which allowed staff to balance the large cap equity styles. The benefit of these extra tools has jumped out just a few months after the Board took action.

MR. O'LEARY commented that he has been spending some extra time in these performance reports going into more depth on certain areas. Over the past two quarters he has covered the absolute return strategies, the international structure, domestic equity, and spent a bit of time on high yield bond managers. This quarter he wanted to focus on the Military and Judicial Retirement Plans, as well as the fixed income and real estate portfolios. He said there were no problems with the last two, but the Board has a special oversight responsibility with respect to those portfolios.

Military Retirement Plan
The Military Plan has assets totaling $17.7 million. When Callan was discussing development of new allocation targets for the fiscal year beginning July 1, 2007, the Board heard that the Military Plan has had a more conservative asset allocation, largely because of the fund size and the volatility of the size, particularly in the early 1990s. As a consequence of the conservative asset allocation, when the actuary was doing the review they lowered the discount rate (investment earnings rate) that they use from 8.25% to 7.25%. It is not uncommon for a one percent change in the earnings rate to result in something like a 15% change in the present value of the liabilities. Sixty percent of the assets in the Military Plan are in fixed income, and 40% are equity assets - divided basically 30% domestic and 10% international. The policy that the Board adopted last year has an expected return of 6.64%. Callan has a lower inflation assumption than the actuary, so adding 75 basis points to Callan's inflation expectation to meet that of the actuary brings the expected return to about 7.5%. The plan's relative return is clearly low compared with other public funds because it has such a preponderance of fixed income investments. Given the plan's size, it does not invest in real estate, private equity, etc.

Judicial Retirement Plan
The Judicial Plan has assets totaling almost $88 million. Several years ago the Board took action to make this plan's asset allocation more like PERS and TRS by adding some high yield, real estate, international fixed income, and absolute return - all of those investments being funded from fixed income. Now the Judicial Plan has 61% of its assets, in aggregate, invested in equities and 25% invested in some form of fixed income (15% in traditional, 3% in non-dollar bonds, 2% in high yield, and 5% in TIPS). There is also 4% allocated to absolute return and 10% to real estate. The Judicial Plan does not have private equity or the investments in the Other category. The plan has had performance similar to that of the PERS and TRS plans.

Internal Fixed Income Portfolio
At the end of March 2007, the internal fixed income portfolio had roughly $2.8 billion in assets, or 18.27% of total assets. It is the Board's largest single portfolio. Throughout the history of the retirement funds, the majority of the assets have been managed internally. There was a brief time when a significant portion was managed by an external manager. Prior to the second quarter of 2000,

the portfolio was managed against the Lehman Government Credit Index. Since then, it has been managed against the Lehman Aggregate Bond Index. When Callan compares the in-house portfolio performance it is not against other public funds; it is compared against Callan's core (investment grade) bond style group. Callan builds the manager comparative groups on a pre-fee basis because the fees are very sensitive to the size of portfolios. There is a huge fee savings in managing the fixed income portfolio internally. While there are not many $2.8 billion portfolios for a frame of reference for what it would cost to have it managed externally, it is guaranteed it would be in excess of 10 basis points. To think about this in a true apples-to-apples comparative context, the median core bond manager of a $2.8 billion portfolio, presuming a 10-basis-point fee, would have returned about 6.63%, instead of 6.73%. The performance pattern for the in-house portfolio for all the cumulative periods is better than the benchmark. In a relative sense, it has been very competitive with best-of-breed managers externally.

Looking at calendar years, the performance of the in-house portfolio has been above the custom index for the majority of the periods. There are two exceptions. The first was 2002, a great year for bonds because interest rates were declining, but it was also a very difficult year for credit obligations. This portfolio has always had an investment-grade credit tilt to it. That explains the underperformance in 2002, but it was a great year for bond returns. The other exception was 1999, when the in-house portfolio was being managed against the Lehman Government Credit Index. This index has a longer duration (greater interest rate sensitivity) than the Lehman Aggregate Bond Index. Nineteen ninety-nine was a year of sharply rising interest rates, and a long duration hurt returns. Looking at the attribution analysis graphs, the term structure line has been flat since 2002, meaning that there have not been big performance differences attributable to differences in the term structure of the portfolio relative to the benchmark. Quality has had an upward slope since the beginning of the fourth quarter of 2002, meaning that it has helped performance that the portfolio has not been quite as high quality as the index. There has not been a significant performance difference attributable to sector of the bond market. (The big decline in 2002-2003 would have been largely driven by corporate bonds.)

REIT Portfolio

Real estate investment trusts have been a spectacular sector in the marketplace for some time. The Fund's REIT portfolio, which currently holds 40 securities, is managed internally by Steve Sikes. The portfolio approach was changed on 12/31/05 to become more broadly diversified, which pretty much coincides with him assuming responsibility for it. As a frame of reference on Callan's database of external REIT managers, REIT management is comparatively expensive, often in the 70 to 100 basis point range. Since the beginning of 2006, the REIT portfolio's variations from the benchmark on a quarter-by-quarter basis have been comparatively small. The one-year return number is an illustration of the importance of the time period because, of those four quarters, one was flat, one was up a little, and two were down a tad. The return picture would be different for a year plus one quarter period. Looking at the portfolio characteristics of price/book, projected earnings growth, and dividend yield, there seems to be a value tilt to this portfolio, which was the intent when it was established. This is a highly volatile area and REITs have not been doing well this calendar year.

MR. O'LEARY next reviewed the Supplemental Benefit System (SBS) and Deferred Compensation Plan (DC) portfolios. Performance during the quarter ended March 31, 2007 was not great almost across the board, but it was essentially in line with expectations. The majority of the investment options met or exceeded appropriate targets for the trailing 12 months. Those that lagged for the 12 months were primarily the active "silo" options (so the undiversified options). The biggest laggards for the 12 months were the T. Rowe Price Small Cap Stock Fund and the Citizens Core Growth Fund. Fortunately, both did have a strong quarter. Brandes International Equity Fund had a very strong quarter, which raised the 12-month results back above target. The State Street Global Advisors funds, which are available as stand-alone options, all performed on track. The Stable Value Fund, managed by T. Rowe Price, is working as expected.

MR. O'LEARY stated that Citizens Core Growth Fund, the socially responsible investment vehicle, is on the manager watch list for poor performance, so it was very important that they had an excellent quarter ended March. But the fund continues to deserve being on the watch list. There has been a lot of industry talk about increased interest in socially responsible investment vehicles. It is still a very limited universe from which to choose. At an appropriate time, Callan would be happy to show the Board the best in the class.

MR. O'LEARY reviewed the SBS asset allocation. The Alaska Balanced Fund is still the biggest allocation. The Alaska Balanced Fund, the Moderate Balanced Fund, and the Target 2010, 2015, 2020 and 2025 Funds all outperformed their benchmarks slightly for the last year. He drew attention to the component funds that T. Rowe Price uses to build the target maturity funds. The international equity fund and the large cap equity fund did well relative to their benchmarks for the year. The small cap equity fund underperformed the benchmark. The bond components fractionally lost to the benchmark for the full year. The Target Maturity Funds with the heavier equity allocation probably did a little bit better relative to their benchmark, however, the small cap component would tend to be largest for those funds, and that was why they all ended up in comparable position. The Index Fund did a tad better than the index. The BGI (Barclays Global Advisors) Tactical Asset Allocation Fund was a bit behind the benchmark. The Brandes International Equity Fund outperformed its target. Capital Guardian's Global Balanced Fund had an attractive positive return but was below the index. The Citizens Core Growth Fund had a negative return for the 12 months, but had a strong return for the March quarter. The T. Rowe Price Small Cap Stock Trust had good performance for the quarter but is still below the Russell 2000 Index for the year. The Stable Value Fund had a competitive return relative to the government investment contract master or other stable value measures.

MR. O'LEARY next drew attention the Deferred Compensation Plan asset allocation and mentioned that the majority of the investment vehicles are comparable to those in the SBS Plan.

MS. HARBO asked Mr. O'Leary to comment on the very aggressive nature of private equity firms and the leveraged buyouts they have been doing in the last year or so. She asked if that activity would require more staff oversight.

MR. O'LEARY stated that private equity to him is two different worlds: one world is the buyout arena (mergers and acquisitions), and the other is venture capital. Whenever someone says private equity in the press today they are really referring to the buyout end of the world, which is the dominant part of private equity. Well over 60% of private equity activity is involved with buyouts — taking public companies private, and there has been an unprecedented level of activity there. There is great concern that a bubble is possibly emerging, that is, there is so much interest in getting money into buyout types of opportunities that deals are being done at what might be very expensive prices. Bond managers are really concerned about it because the covenants in bond issues associated with many of those deals are totally one-sided in favor of the borrower, as opposed to in favor of the lender. He said he thought personally that there are buyout deals being done that shouldn't be done. This is where he is comforted by the ARMB gatekeepers identifying the best in breed, and is comforted by the time diversification of their investments with those best-in-breed buyout managers. The reason that the ARMB private equity returns have been so good is because of the deals that had been done one or two or three years ago that are now being realized. It is not as if the ARMB is just entering the private equity arena and buying at the top — the seeds were sown several years ago, and that is contributing to the success. The venture capital end of the world has been a very different picture; it is a longer-term deal, and the returns have not been as spectacular. He said that as long as one has the discipline not to force money into the category, he was pretty comfortable about it.

Because the meeting was ahead of schedule, CHAIR SCHUBERT said the Board would take up the action items recommended by the chief investment officer next, before taking a scheduled break.

7. CIO Action Items

Asset Allocation - Resolution 2007-22

MR. BADER explained that staff encountered some difficulty when designing the approach for implementing the TIPS mandate that the Board approved. TIPS was to be part of the "Other" category pool. The difficulties are that only PERS and TRS participate in the Other pool, while retirement funds like the Judicial Retirement System and some of the new defined contribution plans invest in TIPS. It matters to have all the funds in one place so that the pool can be efficiently managed. The accounting issues were not insurmountable, but it would have been necessary to run the TIPS mandate as two different pools. Staff conferred with Mr. O'Leary and discussed with the Investment Advisory Council the idea of separating the TIPS portion of the Other asset category and establishing a TIPS pool. Callan Associates modeled that asset allocation for the ARMB, which has the same risk and return parameters that the Board originally approved for PERS and TRS.

MR. O'LEARY stated that Callan took 0.5% of what had been in the Other category and explicitly modeled it as a separate TIPS allocation. The analysis ended up at the same place.

MR. BADER drew attention to Resolution 2007-22 that reflects the asset allocation with 0.5% to TIPS. He said that while it is a small pool now, staff believes that the TIPS asset allocation will grow considerably in the years to come, particularly as the ARMB has to become more sensitive about the finite life of the PERS and TRS defined benefit plans. Secondly, the change will make it easier to administer the Fund from an investment perspective and from an accounting perspective. He asked the Board to approve the resolution.

MS. HARBO moved that the Alaska Retirement Management Board adopt Resolution 2007-22 revising the PERS/TRS asset allocation with the TIPS and Other asset allocation as recommended by Callan Associates and the Board's investment staff. MR. PIHL seconded.

The motion carried unanimously, 8-0, on a roll call vote.

Fund Transfer from Barclay's Global International Tactical Asset Allocation Option for SBS and Deferred Compensation Plan Participants

MR. BADER reported that Barclay's has notified the ARMB of their intent to terminate their Global International Tactical Asset Allocation (TAA) Fund, one of the investment options for the SBS and Deferred Compensation Plans. Staff determined that the closest type of fund available to transfer the assets into would be the Alaska Long-Term Balanced Fund. The Division of Retirement and Benefits will notify the participants in the TAA that it is necessary to make an alternative selection or at some point their investment in the TAA will be moved to the Alaska Long-Term Balanced Fund. Further, Treasury staff and the Division of Retirement and Benefits recommend that the Board approve adding the Alaska Long-Term Balanced Fund to the list of investment options in the Deferred Compensation Plan, since it is not available to participants now.

COMMISSIONER KREITZER moved that the ARM Board direct the Division of Retirement and Benefits to include the Alaska Long-Term Balanced Fund as an option for Deferred Compensation Plan participants and to transfer any participant funds remaining in the Barclay's Global International Tactical Asset Allocation option after September 17, 2007 to the Alaska Long-Term Balanced Fund. MR. TRIVETTE seconded.

On a roll call vote, the motion passed unanimously, 8-0.

MR. JOHNSON stated that the Pension Protection Act of 2006 addressed the issue of default options for self-directed plans where there is a menu of investment choices. The act contains a provision that says that when an employer or plan has a default procedure for beneficiaries who do not make particular elections at points in time, in order to ensure the continued ability of the plan sponsor to assign the risk to the self-directed beneficiaries, the employer secures the plan's ability to immunize itself from claims by beneficiaries that they have not been notified if there are annual reminders of what the default process might be if there is a failure to elect. He said the Division of Retirement and Benefits or the Administrators of this plan may well do that already, but he offered it as a bit of information about best practices that the Pension Protection Act of 2006 has.

COMMISSIONER KREITZER said that in a situation like this where the Tactical Asset Allocation option will no longer exist the Division of Retirement and Benefits will be doing one reminder and that's it. But she appreciated legal counsel's information about the Pension Protection Act.

MR. JOHNSON acknowledged that the notification to participants will satisfy the requirements in this situation, but on a continuing basis the whole default process might well warrant an annual reminder.

MR. BADER stated that the Division of Retirement and Benefits has been in contact with Great West and everything is in place to implement the transfer and notification procedures, pending the Board's approval. He said he believed that Mr. Shier and the Division have addressed legal counsel's concern.

Stable Value Fund Changes for the SBS and Deferred Compensation Plans
MR. BADER reviewed the history of the Board approving a Stable Value Fund in 2004. He explained that stable value funds have wrap contracts within them to provide varying degrees of liquidity into the fund. Right now T. Rowe Price, the manager of the Stable Value Fund, has three levels of structured investment contracts — a short-term duration, intermediate, and long-term. Practice within the industry is moving to only two durations for this. T. Rowe Price is capable of making this change, but two of their wrap contracts require that the Board be notified of the intended change. So T. Rowe Price has asked, and the Treasury staff is recommending, that the Board approve the recommendation by T. Rowe Price and staff to revise the current stable value structure from three tiers to two tiers.

MR. WILLIAMS moved that the ARM Board approve the recommendation by T. Rowe Price and Treasury staff to revise the current Stable Value Fund structure from the three-tiered liquidity structure to two tiers. MR. RICHARDS seconded.

MR. TRIVETTE asked if Mr. Bader expected any down side in terms of investment returns. MR. BADER said not at all, that T. Rowe Price has said this will provide for more efficient administration, since the pools will be larger and require less tweaking.

The roll was called, and the motion passed unanimously, 8-0.

Revision to Insurance Provisions of ARMB Contracting Document (Appendix B2)
MR. BADER stated that the insurance provision in Appendix B2 had some vague language that concerned two investment managers with whom staff was in the process of negotiating contracts. Staff conferred with these managers, with Mr. Johnson, and with the State's Director of Risk Management about making certain changes to the insurance provision. The Director of Risk Management has reviewed these changes, and Mike Barnhill, Assistant Attorney General, concurs with making the changes. Treasury staff intends to bring the entire contract provisions to the Board for review at some point, but staff wished to have the Board approve this one change right now in substantially the same form as presented. He asked that the chief investment officer be allowed to

make future amendments with the approval of the Department of Law and/or the Division of Risk Management. He said that if these two agencies are in concurrence with an amendment, the latitude to go ahead would save having to wait for a board meeting.

MS. HARBO moved that the Alaska Retirement Management Board approve the Appendix B2 - Insurance (provided in the meeting packet) in substantially the same form as presented, and allow the chief investment officer to make future amendments with the approval of the Department of Law and/or Risk Management. MR. TRIVETTE seconded.

MR. BARNHILL requested that the motion say, "...with the approval of the Department of Law and Risk Management," because he thought both agencies needed to weigh in on any changes to appendix B2.

MR. BADER said that was staff's intent.

The motion passed unanimously, 8-0.

CHAIR SCHUBERT called a break from 10:42 to 11:01 a.m.

8. Resolution 2007-21 Relating to FY08 TRS Contribution Rate

CHAIR SCHUBERT indicated that the Board would take up the resolution related to the PERS contribution rate later because it was being revised.

COMMISSIONER KREITZER moved that the ARM Board adopt Resolution 2007-21, which would set the Teachers' Retirement System contribution rate at 12.56% for fiscal year 2008. MS. HARBO seconded.

The roll was called, and the motion carried unanimously, 8-0.

Commissioner Kreitzer was excused at 11:05 a.m. and rejoined the meeting in mid-afternoon.

9. Enhanced Cash - Resolutions 2007-23 and 2007-24

MR. BADER and Fixed Income Portfolio Manager BOB MITCHELL gave a slide presentation on establishing an enhanced cash fund, as well as modifying the domestic fixed income guidelines to allow for investment in the enhanced cash fund strategy.

MR. BADER explained that an enhanced cash fund is an ultra-short term bond strategy that seeks higher returns than money market funds with moderately more volatility. The duration would be zero to one year. The enhanced cash fund would be invested in corporate securities, mortgage-backed securities, and asset-backed securities with longer maturities, and would have more flexibility to go down in credit quality. The fund would be able to engage in interest rate, total return, and credit default swaps, as well as invest in non-dollar bonds. The goal is to generate earnings greater than 50 basis points over the total return of the one-month London Interbank Offered Rate (LIBOR). Staff would do this by taking moderate credit risk and liquidity risk.

MR. MITCHELL described the differences between the guidelines for the current short-term pool and the proposed guidelines for an enhanced cash pool.

- The short-term pool tends to specify limitations at the security level, whereas the enhanced cash fund specifies constraints at the portfolio level.
- The short-term pool has no duration limitation, whereas the enhanced cash pool would be limited to one year.
- No security in the short-term pool can have a rating that is below single A, but the single A constraint is applied at the portfolio level for the enhanced cash fund. The effect of this is to provide portfolio managers with more flexibility to build a portfolio that has higher prospective returns.
- A major departure from the short-term pool would be the use of swaps in an enhanced cash fund. There is currently the ability to engage in total rate-of-return swaps in the domestic fixed income portfolio, but to date it has not been used.
- Non-dollar bonds are not permitted in the short-term pool but could be used up to 10% of an enhanced cash fund.

MR. MITCHELL stated that the ARMB portfolio asset allocation has a zero allocation to cash, but staff was recommending using the cash that is sitting in the domestic fixed income portfolio. The majority of the cash being held in the short-term pool is money being set aside for forward TBA mortgage commitments. TBAs are in there to enhance liquidity and the ability to do trades within various types of mortgages. The proposal is to create an enhanced cash fund with up to $150 million of the assets that are currently invested in the short-term pool.

MR. BADER explained that the proposed investment guidelines for an enhanced cash fund would give staff the ability to increase the range of investment tools available to them. These investment tools are used by most of the top-flight fixed income investors around the nation, and he thought the internal investment staff needed to continue to grow their skills. He said he wanted to keep the internal fixed income investment staff challenged, and he believed adding an enhanced cash strategy to their list of responsibilities was within their capability. The plan is to implement the enhanced cash fund conservatively over time. However, one of the visions for this program is possibly using the ability in an enhanced cash strategy as the basis for an enhanced equity index overlay strategy in the future. If staff can demonstrate to the Board that they can beat the benchmark of LIBOR plus 50 basis points, then they will be able to demonstrate that they can get better than index returns from other investments. Right now the ARMB has a Russell 1000 Growth portfolio and a Russell 1000 Value portfolio, and if staff can overlay part of those investments, the Fund will be that much better off. But staff has to demonstrate their ability before asking to go forward with an overlay strategy.

MR. BADER stated that the first resolution would establish the enhanced cash fund. The second resolution would modify the investment guidelines for the fixed income pool to allow investment in the enhanced cash fund.

MS. HARBO moved that the Alaska Retirement Management Board adopt Resolution 2007-23 adopting the enhanced cash fund strategy investment guidelines. MR. TRIVETTE seconded.

MR. WILLIAMS said he presumed that Mr. Bader would not bring the Board this proposition unless he felt he had sufficient staff to handle this responsibility in addition to all their other duties.

MR. BADER replied that he and Mr. Mitchell had several lengthy conversations about this. Implementation of the program will be very conservative to begin with. However, if there are other changes in the future, such as using the fixed income staff to equitize the cash, then he might be asking the Board for some additional staff. But the enhanced cash fund strategy is well within staff's capability at this time.

MR. SEMMENS asked staff to describe a situation in the enhanced cash fund where maturity was significantly longer than one year but the duration was less than one year. MR. MITCHELL said an example would be a five-year corporate bond with a coupon that resets over frequent short periods of time, known as a floating rate security. So its sensitivity to changes in interest rates is significantly muted, and the risk is a credit risk that is longer than one year.

MR. PIHL indicated he was in favor but wanted a yes/no comment from IAC members and Mr. O'Leary. DR. MITCHELL, DR. JENNINGS and MR. WILSON all said yes to staff's proposal. DR. JENNINGS said it would be useful if the Board heard Mr. Mitchell's input on what a really bad quarter might look like. MR. O'LEARY said he was quite comfortable with the enhanced cash fund strategy.

MR. SEMMENS commented that if a large percentage of the portfolio was in longer-maturity securities that had less than one year duration, he wondered if that was a good comparison to the one-month LIBOR used as a benchmark. MR. MITCHELL responded that to the extent you were evaluating the effect of interest rates on the performance of the portfolio, it would be.

MR. RICHARDS asked if staff did a dry run of the enhanced cash strategy. MR. MITCHELL said yes, that staff did a fair amount of historical analysis on the types of securities that they are looking to put in the portfolio, although some historical data is limited. That study has a big influence on how staff would structure the enhanced cash fund. He said it is hard to paint a worst-case scenario, but staff is looking to have returns over time that are 50 basis points above the one-month LIBOR rate and volatility about the same. Fifty basis points of volatility around the one-month LIBOR would cover about two-thirds of the outcomes. Staff will do everything they can to minimize the down side.

MR. O'LEARY said the Board might wonder why it was doing an enhanced cash strategy if there was an environment of very sharply and significantly rising short-term interest rates combined with the portfolio being at its maximum duration. The performance during that short span of interest rates changing would look a lot worse than the cash pool return. It probably would not result in a loss, but it could result in minimal, if any, positive return for that period. Another possibility would be if there were a credit problem with one of the issuers. There is the same potential exposure in the cash pool today, but in the enhanced cash fund staff has greater flexibility in the choice of issuers. There are steps in the proposed guidelines that try to limit that, for example, to no more than 2% if the issuer is a below-investment-grade issuer. Relatedly, there could be some non-dollar exposure. In this type of fund, that is typically making short-term investments in London that may or may not be hedged, and there could be some currency exposure that works against the enhanced cash fund. He said the real risk is just not earning money, as opposed to losing money, over a period such as a year.

MR. O'LEARY said the choice of a short-term benchmark, such as the 30-day LIBOR plus 50 basis points, is particularly important. He mentioned Pimco's Stocks-Plus strategy, which is basically an enhanced cash portfolio that generates a rate of return that is above the interest rate that is embedded in the pricing of futures contracts. If one feels it is possible to earn that on a reliable basis (there is no guarantee it will happen every month or every quarter, but if one can earn it on balance over a three-year period very consistently), then one could theoretically use unleveraged futures contracts in the enhanced cash portfolio to create a portfolio that had a 50-basis-point premium to the S&P 500. That would be a lot better than most active managers do at essentially no incremental risk beyond the risk embedded in the equity market. The key is whether there is the fixed income management skills, and there are not a lot of external managers who manage $2.8 billion in fixed income.

Referring to the domestic fixed income investment guidelines, MR. TRIVETTE sought assurance that the "Limitation on Holdings" section offered the ARMB considerable protection. MR. O'LEARY said yes.

MR. PIHL stated that during his five-year experience on the Board Mr. Bader and his staff have brought numerous advancements and ideas to the Board, and every one of them has panned out. He could not recall anything that went negative and thought that was a record that the staff would continue.

The roll was called, and the motion to adopt Resolution 2007-23 passed unanimously, 7-0.

MR. RICHARDS <u>moved that the Alaska Retirement Management Board adopt Resolution 2007-24, which modifies the domestic fixed income guidelines to allow for investment in the enhanced cash fund strategy, and further authorizes staff to invest up to $150 million of the cash in the domestic fixed income portfolio in this strategy</u>. MR. TRIVETTE <u>seconded</u>.

The motion passed unanimously, 7-0.

MR. TRIVETTE said he concurred with Mr. Pihl's comments and told Mr. Bader that he appreciated staff continuing to bring new ideas to the Board.

CHAIR SCHUBERT stated that, without objection, the Board would hear a presentation from Brandes next.

10. Brandes Investment Partners - International Equity

Staff introduced GLENN CARLSON, Chief Executive Officer, and JUAN BENITO, Portfolio Manager of the Brandes international equity portfolio for the ARM Board. *[A copy of Brandes' slide presentation is on file at the ARMB offices.]*

MR. CARLSON stated that Brandes has outperformed the MSCI EAFE Index, net of fees, since the account's inception in August 1997. He said since 2001 it has been a very good time to be a value equity manager. He briefly gave an overview of the firm, their products, and the portfolio management team. He said their bottom-up value investment style of analyzing companies can often feel counter-intuitive because it requires buying unpopular companies or investing in unpopular countries or unpopular currencies, and it also requires often avoiding popular companies and popular industries. In addition, they don't really look at the benchmarks, so their portfolios can look meaningfully different than the benchmarks. The only way they can outperform for the ARMB is by being different, but there will be times when they underperform handily and it isn't because they are not doing their job or have lost their way. Looking different and going into areas that are uncomfortable and unpopular are integral to being a successful value equity manager. Many of their products are closed to new investors and additional assets from existing investors to assure that they can continue to outperform on their clients' behalf.

MR. CARLSON reviewed the Brandes philosophy and investment process, noting that there are typically 60-70 stocks in a portfolio, with very low turnover of 20% to 40% per year. He discussed the equity sell discipline where they sell a stock when another security with a meaningfully higher margin of safety is identified and available. That way they are always trying to maximize the average margin of safety in the portfolio, because the opportunity for outperformance is in the disparity between value and price.

MR. BENITO covered the portfolio performance as of April 30, 2007, when the account value was $670 million. He said the two most important things are that Brandes has an investment philosophy that works, and they stick to it in good times and bad times, and they have and retain people who can implement the investment process.

MR. BADER stated that Brandes manages money in the defined benefit plans but also has about $212 million held by the defined contribution plan members in a different fund. He mentioned a paper that Brandes published a few months ago about mutual funds outperforming one period and whether that was a predictor of success. He asked for some comment on that paper.

MR. CARLSON explained that the study was done with regard to institutional buyers of investment services, such as the ARMB, and dealt with the performance of funds leading up to purchase and leading up to firing, and performance subsequent to purchase and subsequent to firing. As one might expect, there will be three years of terrific outperformance leading up to the fund getting purchased by institutional buyers. Leading up to the firing, there will be three years of horrific underperformance. At the moment of firing, the fund outperforms again. It absolutely criss-crosses and is fascinating. The decisions of hire/fire are very sensitive, and past performance can be indicative but not necessarily. That is why the Securities Exchange Commission makes fund managers say their record is not necessarily indicative of future performance. So when considering hiring an active manager, board members have to think about if an inefficiency exists that the manager can explain that they are trying to exploit, does the firm have good people, and do they have the resources to do it. If those three things add up to yes, then even if there is a period of underperformance, the board may still want to hold onto the manager. And if there is a period of outperformance, and those answers are no, the board may want to talk to the manager about it.

MR. O'LEARY said he found the Brandes paper very interesting, and it pointed out a number of valuable lessons for people such as board members. He said he was struck that the study identified a group of funds that were successful over a decade and determined that every one of the funds had some interim period of significant underperformance. He recalled that within the first six months of the Alaska State Pension Investment Board hiring Brandes the portfolio owned the stock of a Japanese brokerage firm that went bankrupt. And the Board did not fire Brandes. That is the type of risk that is embedded in the investment process, and obviously, the winners far outdistance the losers.

MR. CARLSON stated that it was hard for him to see how, if an active manager was truly going to add value, they would not go through meaningful periods of underperformance — unless they got lucky. There has to be that tracking error in order for there to be the opportunity to be different and outperform.

MR. BENITO cautioned that Board that they might be happy with Brandes' recent performance, but there will come a time when they visit to talk about recent bad performance. But as long as Brandes sticks to their investment philosophy, that is a good sign.

MR. BENITO spent a few minutes discussing the industry exposure in the portfolio. He said there are over 60 industries in the EAFE Index, but Brandes is only invested in 24 industries. Brandes is taking a professional risk every time they are different from the market because they could potentially underperform. Most managers get fired because they underperformed, not just because they performed in line with the market. If Brandes tells the ARM Board that they are active managers, but the weighting by industry data shows that the portfolio is very similar to the index, then Brandes has lied to the Board. But that is not the case. Brandes has huge overweights in industries like food/staple retailing and telecommunications, and huge underweights because they have no exposure to industries that represent 40% of the benchmark, including oil and gas. It can hurt performance if those underweighted stocks do well. The overweights in the portfolio are where Brandes sees the greatest opportunities and do not represent the securities that have performed well in the past and where they expect those names to go even higher.

MR. WILSON noted that the EAFE Index is established countries, and Brandes is allowed to go up to 15% in emerging markets. He asked how much of Brandes' overperformance is attributable to emerging markets versus the benchmark.

MR. BENITO stated that Brandes ignores the index and instead looks at where the ARMB allows them to invest, which is everywhere except the United States. Even if the Board had selected a different index as the benchmark, Brandes would invest the same way. They restrict emerging markets to 20% at time of purchase, although it could go higher. They have 11%-12% in emerging markets right now, and they invest on an opportunistic basis. Emerging markets have been a positive contributor to the ARMB portfolio performance. Four years ago they were very close to 20% in emerging markets, but as those markets have done very well Brandes has decreased that weighting. Emerging markets have done well mainly because they are commodity based and commodities have done very well. When developed markets do well, emerging markets do even better. When there are problems, the emerging markets are the first ones to suffer. But the emerging market stocks in the ARMB portfolio are in South Korea, a borderline developed market, for example, or in telecommunication stocks. The portfolio does not have the emerging markets stocks that are doing well now, which are commodities and financial services.

MR. CARLSON said that emerging markets account for some of the outperformance but not the bulk of it. MR. BENITO added that maybe 1.0% of the outperformance could be explained by emerging markets exposure. Being able to go here and there, wherever they see opportunities, is part of the Brandes investment process, and that includes emerging markets.

MR. BENITO said that the return of the MSCI All Country World ex-U.S. Index over the last five years has been 18.20% and includes emerging markets. In the same five years, the EAFE Index has gone up by 16.75%. So adding emerging markets to the index, the return went up less than a couple of points.

LUNCH BREAK

CHAIR SCHUBERT thanked the Brandes people for their presentation and recessed the meeting for lunch at 12:00 p.m. When the meeting resumed at 1:15 p.m., Trustees Schubert, Trivette, Semmens, Harbo, Pihl, Williams and Richards were present. After checking on the availability of the participants for the Economic Roundtable scheduled for 1:40 p.m., CHAIR SCHUBERT invited the McKinley Capital Management people to make their presentation ahead of their scheduled time slot.

11. McKinley Capital Management, Inc.

ROB GILLAM, Portfolio Manager and Director of Global Equities, and ALEX SLIVKA from Marketing, made a presentation to the Board about the $454 million non-U.S. growth equity portfolio their firm manages for the Retirement Funds. They noted that McKinley also manages a large cap growth product for the ARMB as well. *[A copy of McKinley Capital's slide presentation is on file at the ARMB offices.]*

MR. SLIVKA reviewed McKinley's 17-year mission to be a global growth equity specialist, saying they have one investment process that drives all of their portfolios. He talked about the assets under management and drew attention to a page of all the returns for their different portfolios.

MR. GILLAM said he was responsible for oversight and implementation of all McKinley's strategies but would be focusing on the non-U.S. strategy in this presentation. He said that McKinley Capital believes they can achieve excess market returns through constructing a diversified portfolio of inefficiently priced securities whose earnings growth rates are accelerating above market expectations. At McKinley the quantitative analysis comes first to screen the universe of companies to find a short nominated set of quantitatively attractive securities. These securities have good risk-adjusted returns compared to the benchmark, have good earnings acceleration, and they are liquid enough for McKinley to buy. The set of securities are subjected to very stringent risk parameters to build a concentrated portfolio but to spread the bets. The last component is where the portfolio management team does its fundamental analysis. They do not believe that an investment firm can have a stable of analysts where every one is the single best analyst on the companies that they cover. Therefore, McKinley tries to rank order all the analysts around the world that cover each company, looking for the best. McKinley becomes an analyst of analysts, finding the best analyst and looking at where that best analyst's opinion on earnings is relative to the street. They then cross-reference or double-check to make sure the analyst's opinion makes sense.

MR. BADER mentioned that he recently read an article about ranking the top analyst that looked at who had the best returns relative to others in their peer group, and also looked at who was the best at forecasting earnings. He asked what McKinley meant by "top analyst."

MR. GILLAM added that another way of ranking analysts is who is the most popular, but McKinley does not pay attention to that ranking. They are interested in the accuracy ranking, as opposed to the return ranking. That is because the return ranking is based on what an analyst covers, which might be different from what another analyst covers, which McKinley Capital believes is not relevant to the opportunity set that they choose from for the ARM Board's portfolio. McKinley is interested in identifying the analysts anywhere in the world who are the most accurate in terms of earnings predictions for the companies that McKinley is looking to buy. And further, they are looking for ones where the most accurate analyst is more optimistic about the earnings profile of a given company than the average consensus.

MR. SEMMENS asked how McKinley Capital had access to these analysts; if it was information anyone could access through their computer at home or if McKinley had some special ability to access them. MR. GILLAM said it was some of both, that just about anybody can get an analyst's opinion because these analysts are in the business of publishing an earnings expectation. It is a question of how fast one can get that opinion, and in most cases McKinley can get it almost instantaneously, while the public might not see it for a week or longer. McKinley pays for access to that data via databases that are in the business of providing detailed earnings-related information broadly across countries and securities.

MR. GILLAM said that more importantly than what McKinley Capital buys is what they sell, because it is the selling that keeps the portfolio out of trouble. They can eliminate falling in love with a stock by having a sell discipline that is as black-and-white as possible, so that if a stock fails to meet the reasons they bought it in the first place it is sold, period. But for a growth manager, they are not necessarily aggressively turning over the ARMB portfolio.

MR. GILLAM provided investment results as of April 30, 2007 compared against both the EAFE Index and the All Country World ex-U.S. Index. He said the growth benchmarks are starting to outperform ever so slightly, however, he was not going to make any predictions. It is good news for McKinley Capital's kind of investment style. He pointed out that rarely is there much over 1.0% in cash in the portfolio, but there were some serious corporate actions in April and May that show more cash, 2.6%, than was actually available to spend.

MR. GILLAM drew attention to a page showing the portfolio characteristics. He said a lot of people believe that maybe larger capitalization companies cannot grow as fast. McKinley Capital actually sees the opposite, where the weighted average market cap of the ARMB portfolio is about $50 billion. So larger companies are the ones that are really accelerating. He reviewed the top ten holdings in the portfolio, as well as a breakdown by sector weights and country weights. He said the portfolio has a lot of exposure in the financial sector, and although it is underweight the broad-based EAFE Index, it would be overweight growth-oriented benchmarks (meaning there are fewer financials in growth benchmarks). A change that has driven the performance is that the acceleration is moving back to more of what is traditionally thought of as growth sectors. So a slight overweight in telecommunications and a bit of an overweight in technology, where three or four years ago it would have been more in materials and industrials that the companies had the acceleration. McKinley Capital is dramatically underweight emerging markets. There is certainly a lot of momentum in emerging markets, which is one of the general aspects that McKinley looks for, but there is not a lot of earnings acceleration. As a result, the portfolio has about 7.0% or so in emerging markets today.

MR. WILSON asked how McKinley's current allocation to emerging markets compares to the last five years. MR. GILLAM replied that it has been on the low side in the last several years. McKinley is very opportunistic, so they will go from zero up to 20-25%, subject to client restrictions. It has drifted down; last year they were underweight emerging markets a little bit, and that underweight has gotten even bigger. For the moment, the acceleration in earnings is not showing up, and as a result there are fewer opportunities for McKinley Capital to pursue.

MR. WILSON inquired if much of McKinley's good performance over the last three to five years has been benchmark driven because of having an EAFE Index benchmark versus a lot of emerging markets. MR. GILLAM stated that their returns are definitely dominated by the developed market securities over short and long time periods. That is largely because that is the larger part of the weight of the non-U.S. world as well. For the emerging market securities that they do hold, McKinley tends to add value. But they tend to have fewer emerging market securities by far than developed, so the overall contribution is greater for developed securities.

DR. MITCHELL asked, given that McKinley's process is somewhat dependent on outside analysts, what Mr. Gillam thought of the analytic community; if brokerage firms were getting out of that business; and if the quality of analysts at those firms was as good as it might have been in light of some of them moving to the private side and other places.

MR. GILLAM said that question would be in the category of what keeps him up at night. Having said that, McKinley sees a lot of movement within the analyst community but not a lot of departure. There are a lot of good analysts who are moving around, some to firms that specialize in their field of expertise, and many have moved to smaller boutique-type firms that are region specific. So McKinley has certainly broadened the coverage of companies where the analysts work over the last five to ten years. But by and large, while analysts are moving, they are not leaving, and their quality is still excellent. Most of the bad apples in the industry are gone, and that is good, but they were the rare exception.

Referring to the risk controls that are part of McKinley's investment process, and the charts showing the portfolio by sector weights and country weights, MR. O'LEARY said there were a couple of areas where the differences seemed large. One was the underweighting in Japan and the U.K. relative to the benchmark, and another was the sector spreads. He asked if the frame of reference for comparison should be the EAFE Growth Index.

MR. GILLAM stated that McKinley Capital thinks of the non-U.S. universe inclusively, meaning the All Country World ex-U.S. Index growth side of things, and not the EAFE Index or the EAFE Growth. However, they recognize they were hired to beat a benchmark, and that benchmark is not the All Country World ex-U.S. Index. So when they think about the risk they take in the portfolio, they are looking at what the EAFE Index is telling them by sector and by country. Because McKinley builds concentrated portfolios, they cannot be exactly equal weight Japan and the U.K. and all the countries and all the sectors — there are simply too many of them. So in the case of the two largest countries, the U.K. and Japan, McKinley's rule is plus or minus 50% to the benchmark weight. They are close to their minimum because they are underweight both of those countries, but that is within the guidelines of their risk controls.

At MR. O'LEARY's request, MR. GILLAM described what an active weight is and gave an illustration of an active weight in the portfolio. He also explained that in most cases McKinley will own nothing of a security in the index they don't like. However, from a risk control perspective, they pay attention to the top two or three single securities in the index by weight. If the securities are 3.0% or more of the index, and if they look marginal in McKinley's process, they will own them in an underweight scenario. They do not own any in that scenario currently for the ARMB portfolio and haven't in some time. For the most part, they either like it or they don't, and if they don't, they won't own it at all.

MR. O'LEARY asked, if the All Country World ex-U.S. Index has a 15% weighting in emerging markets, and the client benchmark is the EAFE Index, which has a zero weight in emerging markets, but McKinley is permitted to use emerging markets, how the two portfolios would differ. MR. GILLAM responded that very rarely would the portfolios differ; the emerging markets weight would be the same in both products. He added that for the non-U.S. growth strategy that the ARM Board is in, almost all of McKinley's clients have exactly the same rules as the ARMB. They are either an EAFE Index policy benchmark that allows the flexibility to be in emerging markets, or they are an All Country World ex-U.S. Index growth benchmark that allows the same flexibility. Therefore, those portfolios look the same.

MR. SEMMENS said he wanted to commend McKinley Capital for its investment in Alaska's young people through the Gillam Foundation scholarships.

MR. GILLAM introduced scholarship winner Brook Ivy in the audience, who was born and raised in Alaska, and who was working at McKinley Capital as an intern this summer. She plans to be a teacher in Japan.

12. Economic Roundtable Discussion

Panelists: GLENN CARLSON, Brandes Investment Partners
ROB GILLAM, McKinley Capital Management, Inc.
DAN PIERCE, State Street Global Advisors
MICHAEL FRY, Lazard Asset Management LLC
JERROLD MITCHELL, Saltonstall & Company

Moderator: GARY M. BADER

MR. BADER: Should the high returns from 2003 to 2007 change our expectations of returns in the future in the international markets?

MR. CARLSON: It has been a phenomenal time, and currencies have helped a lot. It has been a benign time for markets around the world, and emerging markets have done very, very well. I definitely wouldn't look back at the past five years and say that's what you should expect for the next five or ten years. That seems a bit much.

MR. PIERCE: SSGA actually does a quarterly forecasting process, and our numbers have been undershooting what the markets have been doing for a long period of time. But I think there is a dynamic in the markets right now that suggests the very positive conditions that we've been seeing can continue for some time. What happens in the aftermath is a little bit more tricky because valuations, while not ridiculously expensive, are not that compelling, both on the bond side and to a lesser extent on the equity side. So as long as everything around the world is going well, we likely can see returns do better than what our formal forecasts produce. But at some point in the future, when things go less well, valuations may prove to be a challenge, and the underlying earnings may prove to be a challenge also.

MR. BADER: Should investors be doing anything differently, in view of the high returns that we've experienced?

MR. PIERCE: The answer is yes in terms of what stocks they are holding and what sectors they are exposed to. We just discussed whether returns have been abnormally strong, which we think they have been. So the thing we think you should be doing differently at the moment is being much more cautious of what sorts of stocks and sectors you are holding, and particularly those that are exposed to over-earnings — the cyclical sectors, some of the industrial sectors, some of the material sectors, where returns have been way above historical returns. So be more cautious. Small cap has done great, so you'd want to be more large cap, a little bit more in some of the more defensive sectors, and focusing on stocks where there is something going on independent of the economy.

MR. BADER: Dr. Mitchell, it was about ten years ago when you last managed an international portfolio. Are you doing anything differently today than you did when you left Wellington?

DR. MITCHELL: No, I think not. I think every manager should do what he or she is best at, and that is what I'm still doing, which is picking stocks one at a time. I think from the institutional point of view it is a great time to rebalance. *[laughter]*

MR. BADER: Okay, I hear what you said.

MR. O'LEARY: Dr. Mitchell, I can't pass up the opportunity. Are you benchmark agnostic? Do you make big bets?

DR. MITCHELL: Yes, I am benchmark agnostic. My client, and it is only one client, is a taxable family, and so they are not interested in benchmarks, they are interested in making money.

MR. BADER: Mr. Gillam, do you think you will be doing anything differently in the future than you've been doing in the past?

MR. GILLAM: Categorically I hope not because we'd get fired by everybody. We believe one thing, hopefully we'll always believe that one thing and not change what we do. I do, however, agree that that might mean some of the tilts in terms of industries and countries will change as the growth profile of those same countries and industries changes. I mentioned some of them here a few minutes ago. But having said that, we have no plans to change what we do or what we believe.

MR. BADER: After so many years of high returns, in which countries and industries are you finding the best opportunities now?

MR. GILLAM: Not to be too repetitive, we have seen a pretty big uptick in more traditionally growth-oriented sectors — technology, telecom in particular. In countries, still the developed versus the developing. As I mentioned, the more developed Europe, so Spain and France in particular, and Germany to some degree as well.

MR. BADER: Dr. Mitchell, in which countries and industries are you finding opportunities?

DR. MITCHELL: Industries, large cap consumer stocks, and still energy. Countries, Japan.

MR. FRY: A little bit of a similar answer. I just got back from Tokyo before I arrived here, so Japan is becoming more interesting now that it has underperformed for the last 12 or so months. Once again, large cap, some of the pharma stuff, European insurance, and restructuring in Germany, which has done well and we think will continue to do well.

MR. PIERCE: I share the general enthusiasm for large cap. I like resources and things that are related to global infrastructure in some way. Not so much utilities, but industrials, materials, these kinds of things. Not as enthusiastic about Europe. I think the core of Europe is pretty solid, but there is some fraying around the edges, if you will, in some of the peripheral countries with consumer leverage having gone on too far. Also perhaps in the U.K. I think we still have to pay a lot of attention to the emerging markets. I think there is a lot of reluctance to go more aggressively into emerging markets at this point because they have done so extraordinarily well. But I think that reflects a lot of very positive fundamentals that are apt to continue, therefore they can continue to do well.

MR. CARLSON: Today we don't look around the world and see any area that looks like it's screaming value. So we think it looks more normal. Where we're not finding ideas would be energy and the basic cyclicals. We think that the return on equities that are showing up there and have been there for a long time, we're not sure that they are sustainable. So our valuations suggest that at least they are at fair value, and we're always trying to buy undervalued businesses. In terms of countries, nothing stands out in terms of a particularly wonderful opportunity because there is an issue going on there. Of course we always like a lot of problems, and there aren't a whole lot of terrible problems going on in the world at the moment. More benign than we like it.

DR. JENNINGS: Could you highlight the pros and cons of a separate international small cap allocation for a board of this size and sophistication - both in general and at the current point in time?

MR. PIERCE: I think small cap in general, perhaps less so overseas, is kind of extended. So at this time it's maybe not the most urgent choice that you have to make. But, in general, there is something to be said for looking at small cap separately because even at the index levels they tend to separate it. The benchmarks tend to focus on the larger caps. So without something specific in the small cap, it is hard to get maybe the kind of attention you need there. But at this point, I guess I still have to favor international small cap at the margin, but I think its best period is behind it, at least for the time being.

MR. O'LEARY: Nobody has said anything about currency. Currency has been a huge contributor to return. What do you do about it? Do you manage that aggressively, or do you just let it be embedded in the securities that you select?

MR. GILLAM: We're not a currency specialist, but yes, we would agree that currencies have been certainly helping the non-U.S. allocations. We do look at it from an embedded standpoint. So our view is that when the wind is at your back, you should take advantage of it, and that is certainly what we've been doing. It also has an effect on earnings of companies, of course, which you want to be paying attention to, making sure you're not getting currency headwinds with companies that are maybe selling into the U.S., producing in higher currency environments, things like that. It is definitely something that needs an active review, from our perspective.

DR. MITCHELL: I would note that currencies always tend to overshoot, so whenever you think that the dollar versus the euro is going too far, it will go further.

MR. TRIVETTE: Mr. Carlson, you talked about currency helping Brandes' international returns, and we've heard that from other managers as well. Is it your expectation that that favorable impact will continue in the next couple of years?

MR. CARLSON: I'm literally the worst panelist to ask that question of because we have absolutely no clue at all. We have no economists, and we do no currency forecasts at all. Currency is purely embedded. So if you want just an anecdotal opinion with zero foundation at all, currencies do overshoot and then they go back. The euro was at 80 cents and now it's at a buck twenty.

MR. PIERCE: Let me throw in some things to think about. First off, we all talk about the dollar being weak, and we believe that the dollar will tend to be weaker over the longer haul. But it has been quite weak lately. It has not been weak against the Japanese yen, so it is by no means uniform. There are some currencies that have done very well and some that have done poorly. Depending on how much flexibility you want to think about, you might consider some sort of partial hedges on the euro or British pound to currencies that have done extraordinarily well. You can see why they have done well, because Europe has done so much better than folks expected over the last several years.

But maybe a lot of that is in the price right now. And maybe some of these things that I was mentioning earlier about the periphery of Europe and also the U.K. might weigh on those currencies. The other thing is the U.S. is perking up a lot better than folks expected. Everybody is sort of thinking about the housing market and how bad that is going to be for the U.S. economy, and the housing market may well be very difficult, but the trick has been that it hasn't broadened out into more severe damage across the economy as a whole. The dollar may do a little bit better. Longer term, it really depends on your time horizon as to how you want to play that, but I think you want to think in terms of a weak dollar maybe not being as much of a tailwind in the near future.

CHAIR SCHUBERT: What is going to be the next great investment opportunity? For example, five years ago if someone had said would you consider buying a toll bridge in China or India or someplace like that, I would have said no. So I'm wondering what's next.

MR. FRY: I think it is incredibly difficult with this amount of liquidity in the world and well into an economic recovery, there's not much that hasn't been picked over. It is very, very hard to find stuff that looks egregiously mispriced. So I don't know what the next asset class is. I think what you do is get on with the stock side of things. But picking an asset class — very difficult. I cannot think of one at the moment that feels really out of whack with what I think fair value would be. There are plenty of stocks you can find, but not so much asset classes. Sorry, it's a non-answer, but that's the way I see things.

MR. GILLAM: Not to give any expertise on asset classes, but more within the equity space there are a couple of categorical themes that we certainly see over three to five years. One is just broad restructuring, share class restructuring. A lot of European families control companies. Julius Baer comes to mind. Restructure the share class, the controlling class, and all of a sudden the company is a different company. Why? Because the company is in play, it's got a lot of restructuring opportunities that previously weren't available because there was family control. So as you see some of those corporate structures changing, there are maybe some opportunities there. That probably falls in the category of individual positions. The other thing, despite what I said about emerging markets, emerging markets are set to radically increase in at least MSCI benchmarks, as we understand it. Of course, if you have money chasing passive funds, that is probably going to provide a little bit of a tailwind to emerging markets as that occurs late in 2007 and into early 2008. So not asset-class-based, but more specific anomalies within the non-U.S. equity space.

MR. BADER: Mr. Carlson, you said Brandes has no economists and no view on currency. Yet currency is a big driver of returns. Is the fact that you have no economists and no view on currency another way of saying you don't think you can decide the direction of currency and you view it as a zero-sum game? Why don't you have an opinion?

MR. CARLSON: We think it's a zero-sum. And we think there are ways that you can handle the currency question, and that would be a hedging policy — or not, just recognizing that that is the case. Our view is that it would be difficult to identify a tremendous amount of active opportunities in currency. Mr. Fry may tell you something different, and there are other organizations that could certainly tell you something different. Our view is that those are pretty unpredictable outcomes. We take a look at what currency means in terms of the underlying business. We may have some very broad currency issues. When the sovereign rate spread was so huge in emerging markets four or five years ago, we were putting into our valuations that it didn't sound reasonable for the long term. That obviously has an impact on currency. But in terms of having a clear vision on where it is and that it's a unit that we include in our valuation, generally it's not. If somebody told me I had to throw a number down and it would have an impact on our valuation, generally we just use current value.

MR. BADER: Does anyone on the panel have more than 25% of the portfolio hedged?

DR. MITCHELL: No.

MR. BADER: Ten percent? *[no response]* Five percent? *[no response]* Okay, I think we dealt with that one. *[laughter]*

MR. PIERCE: We have some clients who have portions of the portfolio hedged. In many cases, it is the client's decision on how they want to approach that.

MR. BADER: Growth versus value. We have growth managers and growth managers on the panel. Does style diversification matter? And if so, what is the magnitude of the benefit?

MR. GILLAM: Obviously we're a little biased on the growth side of things. We wouldn't be so foolish to stand up here and say that growth is always going to win. We do believe, and we've done quite a bit of research on the idea that the styles are different, and as such, there is some benefit in having some of both. There are a lot of great managers out there, a lot of great value managers out there, and represented here, of course. But our view is that they are different. We've done quite a bit of work for clients, most recently in emerging markets space, and indeed, still in that space they are different. As such, maybe worth a little bit of investigation in terms of putting pieces together. Just anecdotally from our own client list, we don't have a lot of clients that are massively overweight growth, to our benefit. But nonetheless, there has been recognition in the last three or four years that at least outside the United States maybe it is different and maybe worth investigating, and obviously possibly we're here because of your investigation of that. So thank you for that.

MR. CARLSON: For the past ten years EAFE Value has annualized at almost 5.0% more than EAFE Growth. That seems unsustainable to me. Being a value manager, I should say that is going to last forever, but that seems like a large spread.

MR. PIERCE: I don't necessarily know that that is unsustainable because there has been migration from the Value Index to the Growth Index and back and forth. So who can tell me exactly what a growth company is? The indexers have an awful hard time with it because they change - a lot. I can understand some managers have a style that lends them to certain kinds of companies, and other managers have a style that lends them to "cheaper companies," whatever that means. But isn't it better to have somebody who is willing to access all different kinds of opportunities and make the most of them across the entire broad spectrum, especially when the indexers can't really tell you with a great deal of definition what growth and value really mean?

MR. GILLAM: We absolutely agree there is a definitional problem at the index level, and we made ourselves a little less popular by writing a little paper on that. But having said that, I think it's a question of who you are and what you do well. And if what you do well, and in our case we think we do growth well, is different than somebody else, mathematically there is a benefit in having those two people together. Whether they access a big universe or a small universe, there is a correlation benefit to putting together people who do things differently and have a different movement. So growth and value are different, and as such they are worth a review.

MR. FRY: In the ex-U.S. space I think the growth versus value debate empirically has been less important. I think this has been very interesting, and we've touched on it here in a few of the comments, what is growth and value in materials stocks or cyclicals. You need to recognize that these things change over time at the stock and industry level. Therefore, the definitional levels will change. We tend to have a value bias, if you like, but try to access everything because as the structural forces play out in some industries, we want to be out of those industries into ones we think are favorable. So it comes back to analyzing and looking for good stocks and good industries that are inexpensively priced, as opposed to a style bias. But I understand that at the aggregate level for trustees, you want to make sure you understand what manager groups you have and what biases you might have in your aggregate portfolio base.

MR. O'LEARY: Clients and boards ask me tough questions, so I like to deflect them and ask them of you. Today there is a report of additional trouble, violence in the Middle East, oil is over $67 a barrel. A couple of months ago the Chinese local market declined 10% in a day, interest rates are significantly higher than they were just a couple of months ago. We're still reading about the subprime meltdown. All of you have said in one manner or another that things are not cheaply valued. Why are you all fully invested?

MR. FRY: If valuations were expensive and inflation was a serious problem, I think there would be a strong case for being quite negative. There is also an angle to this, that we are paid to be pretty fully invested because we're running specialist products, and the allocation decision is often taken out of our hands by the client. So that is probably one major reason we're fully invested. But the question should we be really scared now is an interesting one. Because as you said, we're all caught in this sort of framework where we're saying things don't look very, very cheap. By the same token, with fairly low inflation and decent growth, equity markets have discounted a modest slowdown in economic activity. At least I believe they have. So therefore they have tried to take a slightly cautious view of things. I don't think that it is obvious that everything is overvalued, but I do think that we are cautious in the sense that we can't find pockets of under valuation. That does seem to signal that I would lean to the cautious side. Whether that would cause me to go substantially into cash, I'm not so sure.

MR. CARLSON: I hope those headlines that you just outlined come to fruition with meaningful market declines. That would be great for all of us, truly. It would not feel good for the next couple of months, but from the active space, it is that volatility that provides the opportunity. You require that. That was all music to my ears, Michael. Thank you very much for that.

MR. PIERCE: This is the curse we've had, that volatility has been so low. It provides a serious underpinning for a lot of markets around the world, especially with the global economies as strong as they are. You have remarkable synchronization in global growth. So we have these issues, but the markets generally always have issues. And the more underlying dominating theme is this sustainability of growth and the profits that go with that. Round numbers, valuations are in the mid-teens on a P/E ratio. It is not as cheap as you might like, but it's not ridiculous either.

MR. BADER: Domestic stocks and international stocks have been highly correlated, over 80% the past few years. The outperformance perhaps of international stocks can be laid largely on currency improvements. Why should we have international in our portfolio?

DR. MITCHELL: Let me begin. I think it is really the opportunity set. Correlations are now higher than they used to be. They may not always be, but right now they're higher. But the opportunity set is enormous. And if you disregard that, you'll miss some great investments.

MR. GILLAM: I would say also that just because correlation is positive doesn't mean the magnitude is the same. So you could have two things that are highly correlated, but one does consistently 10% and the other does 1%, and they move together, but the magnitude is different. That is something to consider as well. But we certainly would agree that the opportunity set continues to be significant in the non-U.S. space.

MR. FRY: I talked about Germany before. The U.S. is a very efficient economy in most respects, in terms of the corporate side. Germany just emerged as a major opportunity over the last two or three years if you were onto that early enough. Japan could be the one over the next two to five years. So there is lots of stuff going on that comes under the opportunity set banner. But you just want to be looking around for anything you find anywhere. I think there are more opportunities in international space, personally, than in U.S. space. That's not to say there is none anywhere, but I think it is more fertile.

MR. BADER: We've read a lot about private equity and its growing impact. Has the expansion of private equity had any impact on your processes? Will it continue? I'm referring to the leveraged buyouts here.

DR. MITCHELL: I think it has. Investors are always looking for a catalyst that will affect the investment decision they want to make - they are just waiting for something to happen. In many cases, when you look at international conglomerates and international family dominated companies, a few years ago that catalyst might have been way out in the future. It isn't anymore, with the growth of private equity. Whether it is Hansen a month or two ago, or whoever the next one is going to be, you are going to get a lot of action there. So I think it is a favorable thing for the public markets.

MR. CARLSON: I would generally agree. We've seen it quite a bit in the non-U.S. markets. There is this concept of taking real estate out of a business operation and owning the real estate separate from the operating company, so private equity has been floating around there quite a bit. It is a chance to unlock value a bit more quickly. But private equity has only an interest in trying to get an above-average rate of return, so they are trying to buy these assets at a discount. And if we're a substantial owner of these businesses, and they are trying to get assets from us at a discount, it is going to require a fight. So I think that's where activism and corporate governance comes into play.

MR. GILLAM: We would say that anything that brings management focus on growing their earnings is a good thing. And if you're sitting in the corner office somewhere and you're worried that some private equity titan is going to come in and take you over and break you up and fire you, you're probably going to be focused. So that focus is always good, whether it is private equity or any other phenomenon. Focus on driving the bottom line, which hasn't always been a huge focus in non-U.S. companies. That focus is a good thing.

MR. PIERCE: One thing we have to think about is the possibility for shorter time horizons with the private equity folks. They tend to want to generate a higher return by doing things over maybe a couple, three-year period, maybe five years, as opposed to in perpetuity. The private equity forces now are a nice underlying source of demand in the markets, but maybe two or three years down the road, as they try to realize profits on these investments, they might be an underlying source of supply.

MR. WILSON: As you look at allocations in the equity markets over the last five years, returns have been driven by emerging markets and international. And if you had a big weight to domestic, it doesn't look as good. As you look out the next five years for an institution like the Alaska Funds, how do you see that playing out, and how would you do an asset allocation in your equity space?

MR. FRY: I think I'm the only one here doing global, so maybe I should have a crack at it. Emerging markets structurally, even though you need to be more cautious. Certainly the stronger growth and better corporate governance and better economic performance are all structural factors that have happened in emerging markets, and therefore that sets it up for a very long period, just given the growth that you are going to get there. But be a bit careful near term because it has run a long way. I also have been pretty happy with Europe because, unlike the U.S., it hasn't restructured anywhere to the same degree. So you've got that catch-up in Europe. But once again, that has now played out to a reasonable degree, at least a chunk of it has happened. So I think you've seen partly the cycle lifting the emerging markets and also Europe, because European growth has picked up strongly versus the U.S. The U.S. has come off a bit. So the cycle has helped ex-U.S. But the structural characteristics that I described in emerging markets, plus there is still to catch up in Europe in restructuring which means ex-U.S. does at least as well, if not better, over the medium term. Having said that, the U.S. has looked a bit worse than it should at the moment because we're seeing the economy soften over the last 12 months, so relative performance has dropped away. So longer term, overweight emerging markets, probably still a believer in being overweight Europe versus the U.S., but I wouldn't be pessimistic on the U.S. There are still lots of stocks here, and it has underperformed a little bit, so it is a little less loved with the subprimes, etc. It is not a sell, but I'd say probably structurally slightly underweight versus Europe and emerging markets.

MR. PIERCE: I'll throw in a kind word for U.S. large cap, not universally, and I'm not sure that it's going to outperform international. But I think there's going to be some more fertile pickings among U.S. large cap, simply because the vast pools of capital in Asia and the Gulf countries that are looking to diversify their investments out of bonds are going to need places that can accept that kind of capital. Some of the U.S. leading companies, especially those that don't dilute their shares with options to a heavy degree, will benefit from that source of demand, it seems to me.

MR. WILSON: Just as a follow-on, most institutions around the world tend to have a more balanced view on the world, whereas U.S. institutions tend to have portfolios that are more focused on the U.S., more of a tilt. Do you advise U.S. institutions to have a more balanced view, 50/50 split, or 60/40 split when you throw in this currency thing? It really drives a lot of the returns that large U.S. institutions earn.

DR. MITCHELL: I see no reason why long term it shouldn't be 50/50, but I wouldn't advocate going there tomorrow. I think that as you do asset allocations every year, major ones every three years or whatever, you probably should look toward that 50/50 goal but not have a date certain as to when you're going to get there.

MR. CARLSON: We're seeing more and more institutional clients move from our non-U.S. equity offering to global. So a lot of institutions are recognizing that and saying let's not carve this out, let's just allow you to make the asset allocation decision based upon your process. I think that's a suggestion that more institutions are becoming a bit less home-market biased. Though the home-market bias exists around the world, it's not just the U.S., it's very strong around the world.

MR. WILSON: So what is the split in your global product right now?

MR. CARLSON: We're right around 50/50 today, but we range pretty broadly, depending on where opportunities are.

MR. TRIVETTE: Are issues like the U.S. debt and the large influx of foreign money into the U.S. likely to have much impact upon the market long term?

MR. PIERCE: I think that is one of the negatives for the dollar, the fact that these folks own so much

U.S. instruments, particularly debt instruments, that they are going to want to find ways to diversify. I mentioned the equities as a possibility, because if they're worried about the currency exposure — let me say it this way — in an economy that is growing really well around the world, they don't want to be stuck in a fixed income instrument that just doesn't have as much up side, so they're going to look more at equities. Yes, it is probably a source of pressure on bond yields to the up side.

MR. BADER: What do you feel is the largest under-appreciated risk for a U.S. investor investing internationally? What risk factor is not being priced correctly in today's market?

MR. GILLAM: Everybody talks about geopolitical risk and all that stuff, but I think custody risk is a big issue. If you watched what occurred in Thailand late last year, you have what a lot of people perceive as a very stable place. We all read about Venezuela, and maybe that is the extreme - I don't see a lot of people rushing in there to hold their assets in Venezuela. But even in places like Thailand, which is generally considered more stable, a lot of people visit there, a lot of people vacation there, yet, one day you go to bed, the next day you wake up and there are tanks in Bangkok and a couple of months later they're deciding let's impose currency controls, and oops, that didn't work out, let's do something different. So I think you really have to have a good handle on custody and are your assets retrievable. More so for a lot of people who have come into emerging markets more recently, maybe they are not quite as familiar with those risks. So I think that's something to pay close attention to.

DR. MITCHELL: I would add behavioral risks, and under behavioral I'd include both political and sociological. As more U.S. investors look at international companies through the eyes of sector analysts, they tend to say, well, a drug company in the U.S. is the same as a drug company in China is the same as a drug company in emerging Eastern Europe. That may be true in terms of the chemical compound, but it is not true in terms of what might happen in those markets. So I think that is a risk people may be surprised when they find out that it's not just another drug company.

MR. PIERCE: I'll throw out the term protectionism. If we get in any kind of trade wars, in terms of Congressional action here or in terms of retaliation elsewhere, this is something that could sort of upset the apple cart in terms of how well the global economy is doing.

MR. BADER concluded the roundtable and thanked the panelists for their comments.

13. State Street Global Advisors - International Equity

NEIL TREMBLAY, Senior Relationship Manager, PETER KASHANEK, Investment Manager with the Global Quantitative Active International Group, and DAN PIERCE, of State Street Global Advisors (SSGA) made a presentation on the core international equity mandate they were hired to manage in May 2005. *[A copy of SSGA's slide presentation is on file at the ARMB offices.]*

MR. TREMBLAY stated that their goal is to outperform the MSCI EAFE Index by 2.0% or better over a market cycle, while deviating no more than 2%-4% on a tracking error basis against that benchmark. To date, they have met expectations.

MR. KASHANEK said the ARM Board hired SSGA to manage a core developed market portfolio, and they believe core is the right way to invest in international markets. Core to them means eliminating any style or thematic investing and remaining neutral to the benchmark based on the various sector allocations. Instead, they rely on stock-picking skill to build a portfolio that looks a lot like the benchmark from a risk-control standpoint but that is designed to beat that benchmark consistently.

MR. KASHANEK briefly reviewed the investment team for the international alpha strategy, noting that there have been no changes on the team other than adding a few people in recent months. The new people are a function of asset growth as plan investors are interested in getting exposure to the markets that have had impressive returns.

MR. KASHANEK drew attention to the ARMB account performance as of April 30, 2007. The current account value is $433 million, having earned 21.18% for a one-year period versus the EAFE Index return of 19.81%. He said in the third quarter of 2006 they were hurt by five stocks in the portfolio that pre-announced to the market that they were not going to meet their earnings expectations. Those five stocks naturally went down quite quickly and dramatically, and that hurt performance by about 50 basis points in the third quarter. Barring that one quarter, they have done well this year and continue to run ahead of the benchmark.

MR. KASHANEK reviewed the characteristics of the ARMB account, pointing out that on a sector basis the portfolio is pretty much in line with the benchmark. He said SSGA looks to find stocks that have high growth potential, are attractively valued, and have high quality earnings. So the portfolio has a growth premium to the benchmark but has a valuation discount. This is how they maintain core exposure and do not become too beholden to growth stocks or value stocks being in favor in the market. SSGA believes that consistent application of their core philosophy and investment strategy is the best way to long-term value creation, and they don't deviate to catch the latest fad in the market.

MR. O'LEARY drew attention to SSGA's zero weight to emerging markets, which are not in the EAFE Index. That is an illustration of the discipline of trying to minimize the risk of being different from the benchmark. The Board has another quantitatively oriented manager who has the same benchmark but has a very different attitude, and he wanted to underscore that difference.

MR. KASHANEK stated that SSGA believes that emerging markets can be a great place to be, but their process is designed for developed markets only. So emerging markets is something they will never be in in this particular product.

MR. KASHANEK said that one of the hallmarks of their process is that they do not depend on any one industry or one region to drive performance but try to find the best opportunities within each region and within each sector. He highlighted Arcelor Mittal, a materials company that SSGA has held for most of the past year and a half and continues to benefit from greatly in the portfolio. Energy is an area where SSGA has done very well. In general, a lot of energy companies are fully priced, but that doesn't mean there aren't opportunities. Petroleum Geo-Services is an oil services company in Europe that SSGA was overweight and that has benefited performance in the first four months of 2007. Performance across stocks held in Japan has been good year to date, despite the fact that the Japanese market in general has only been up a few percent.

MR. O'LEARY mentioned that Mr. Kashanek had reported earlier that SSGA had added to staff because of asset growth. He said people tend to think that a manager can manage a lot of assets with this type of strategy, but there are costs associated with turnover. He asked Mr. Kashanek to speak on a reasonable capacity limit and to describe to the Board how the SSGA assets base in this product has changed.

MR. KASHANEK replied that SSGA's international alpha strategy was closed to new investors at the beginning of 2006, in order to manage the risk. They close strategies to new investors long before the strategies are really at what they call a hard-cap limit. In aggregate, there is about $5 billion under management in the EAFE benchmark assets.

MR. KASHANEK spent a few minutes reviewing the three-step international alpha investment process: (1) security analysis and balanced ranking with growth and value factors, (2) risk assessment — allowable exposure to the benchmark weightings of country, industry, and market cap, and (3) portfolio construction, where the portfolio management team qualifies each trade that the model has suggested. State Street Corporation holds about $20 trillion in custody, which means that SSGA gets good service from Wall Street and the global brokerage community. That is why SSGA is able to trade and manage their clients' accounts cost effectively.

CHAIR SCHUBERT thanked the SSGA gentlemen and called a scheduled break at 2:50 p.m. She gaveled the meeting back to order at 3:05 p.m. Commissioner Kreitzer rejoined the meeting during the break.

14. Lazard Asset Management - Global Equity

MICHAEL FRY, Managing Director and member of the Global Equity and International Equity Teams, and ANTHONY DOTE, Director/Head of the Public Funds Team, appeared before the Board to give a report on the global equity portfolio that Lazard Asset Management has managed for the ARM Board since 1993. *[A copy of Lazard's slide presentation is on file at the ARMB offices.]*

MR. DOTE stated that Lazard is a relative value manager that looks around the world for companies that have high returns on equity and that are cheaply priced, and they use price-to-cashflow or price-to-book as the metrics for determining that. He mentioned the change to Jeremy Taylor in London and Ron Temple in New York as global co-directors of research to get them closer to the analysts and to improve the communication, not only among the analysts, but also between the analytical group and the portfolio management group. He said Lazard had been disappointed with their stock selection in Japan, so they added three Asian/Japan analysts to the global research platform to improve the focus on Japan and Asia.

MR. DOTE said that the last seven years represent a market cycle for most managers - 2000 to 2003 being a down market, and 2003 to 2007 being a strong rising market. Lazard defends the portfolio in down markets, and in flattish markets they outperform, but it is very difficult for them to keep up in sharply rising markets that are compounding at 20%-plus. The benefit to the ARM Board is that the absolute returns have been strong, but over the last four years Lazard's relative performance has not been where they would like it to be. But putting the seven years of the market cycle together, Lazard has outperformed the index and been around the middle of the pack relative to peers.

MR. DOTE stated that international markets have been outperforming U.S. markets, the reverse of the 1990s when the U.S. was the best performing country in the world. Small cap stocks have done better than large caps. The ARMB portfolio is primarily a mid to large cap portfolio with not much exposure to small cap, and that hurt the results. Over the last few years Lazard's global equity has been overweighted in the international markets, so that has clearly benefited the portfolio. Lazard put emerging markets into the ARMB portfolio in October 2005, and that allocation has added value. Over the last four-plus years cyclical (industrial) companies, commodity-based companies, and financial stocks have outperformed other sectors. The market has been very narrow in favoring those particular types of stocks. Lazard has been underweighted in cyclicals, commodities and small cap stocks, and that has definitely been a drag on the results. But they believe things are changing, occurring first in the U.S. market, where there is a movement away from those two or three sectors that have dominated performance. Consumer, technology, and health care sectors are starting to perform better. In the U.S. large cap stocks are starting to now outperform small cap. That is not as evident in Europe, but it is clearly the beginning of a trend in the U.S. The last seven years has been a deep value style environment in international markets, and Lazard believes that as the growth style starts to perform well, Lazard's style will perform well with that on a relative basis.

MR. FRY said the evidence at the moment is that the U.S. market is already changing, but it has not yet happened to a great degree in Europe, and certainly not in Japan. The last one or two months have been a much more balanced market, with some defensive sectors doing better, and larger cap doing better, even in Europe. So Lazard believes they are turning from a headwind to a tailwind, in terms of the portfolio structure (large cap bias that is especially evident in the European portion of the portfolio, the quality bias in consumer staples and pharmaceutical stocks, and the underweight in materials and industrials). The surprisingly strong and robust economic environment for the last two or three years is cooling off a little bit, and Lazard believes that is what will cause the change. The valuations in some of the sectors that Lazard is underweight have got a little bit stretched.

MR. FRY stated that capital markets have been incredibly risk-loving over the last few years, and that is because the economy has been so good. Now that the economy is moderating, the spread between high yield bonds (the most risky) and the 10-year German Government Bond (probably the least risky) has narrowed to almost all-time lows. Interest rates globally have been ticking up in the last two weeks, bond rates made the headlines in the U.S. recently, and this is probably the start of some normalization going on in interest rates and bond yields. Once again, evidence that the environment is changing.

MR. DOTE reviewed the performance of the ARMB global equity portfolio. Since inception in 1993, the portfolio has outperformed the MSCI World Index by 1.3%, and ranks 54th in Callan's peer universe. Over the market cycle of the last seven years, the portfolio has outperformed the benchmark by 2.0%, but again ranking in the middle of the pack. Fiscal year to date through March 31, 2007, the portfolio is running in line with the index. The first quarter of 2007 was a difficult quarter because cyclical stocks and commodity stocks did exceptionally well, and being underweight there hurt Lazard. In April and May, the portfolio was up 7.7% and the index was up 7.3%.

MR. O'LEARY mentioned that the U.S. segment of the global portfolio is part of the ARMB domestic equity pool, and the international segment is part of the ARMB international equity pool. He said he wanted the Board to understand that Lazard was managing it as a global portfolio. So if Lazard felt the most attractive financial stocks in the world were U.S.-domiciled companies, they might have essentially none in the international component but what would look like a gross overweighting in the U.S. component. So looking at either of the two big pieces of the global portfolio in isolation would give a very distorted view of how Lazard was doing relative to peers.

MR. DOTE said that was true. As an example, Lazard is underweighted pharmaceuticals in the U.S. but overweighted on pharmaceuticals in the international markets for valuation and return reasons. He also agreed that the total global portfolio has to be looked at versus other global managers.

MR. FRY stated that Lazard feels that oil companies, consumer staples, and insurance are a better value in Europe than in the U.S. The portfolio is being built holistically in the sense that they are debating where relative value exists across the world.

MR. DOTE stated that 54% of the portfolio is allocated to international markets versus the index weighting at 48%. The international small cap portion has shrunk from about 10% in October 2005 to about 2% at the end of March 2007. There is some thought in the shop that they will cut the small cap exposure even further. Emerging markets has gone from about 8.0% of the total portfolio down to 3.0%. It is a question of valuation and returns. They still like emerging markets long term. The Board should expect Lazard to be adding to the emerging market allocation on weakness, but they have taken a lot of gains out of the emerging markets part of the portfolio. Roughly 43% of the portfolio is allocated to the U.S., which is underweight the index weighting of 52%. The U.S. component is committed primarily to mid and large cap stocks.

MR. FRY explained why Lazard believes they are at the beginning of an environment similar to that in early to mid 1994, when the type of companies Lazard buys start to do well, and when stock selection drives better performance relative to other managers and the index. He drew attention to a list of about 140 holdings in the ARMB portfolio by sector. He cited DaimlerChrysler as a stock that Lazard thinks will go up independent of what the economy does. It does not have to do with whether they think car sales are going up or down in the U.S. or globally. It has to do with a company where the management team is into reorganizing the business, getting rid of the loss-making business, focusing on improving the margins at one of the world's best auto brand in Mercedes, and being serious about looking after the shareholders — which was not the case 18 months ago. He said there are a lot of stocks in that category in the portfolio that Lazard believes will make money irrespective of what the economy does over the next 12 months. They are underweight Japan by about 3.0%, but they will likely be pushing that up on the belief that Japan's underperformance is probably presenting more opportunities for the portfolio now.

MR. FRY explained that emerging markets valuations have converged a lot with developed markets compared to three years ago when emerging markets looked substantially cheaper. And emerging markets are actually producing superior returns. So Lazard is not saying that emerging markets are overvalued, they are just saying to be there longer term, take some profits now, buy a lot more if they correct.

MR. TRIVETTE inquired about the turnover rate in the portfolio. MR. DOTE replied that it was in the 30%-35% a year, but it tends to go up in rapidly rising markets or changing markets.

MR. TRIVETTE said that when investment companies have gone public there tends to be a lot more pressure from the stockholders. He noted that Lazard went public a couple of years ago and he wondered if they have seen that yet or if it might be a problem.

MR. DOTE stated that he has been with Lazard for 25 years. There is clearly more emphasis on expense control now, as one would expect in a public company. Their environment prior to going public was a very entrepreneurial, flat organization, and that has not changed. The head of the company pretty much leaves the investment people alone. The synergies between the asset management business and the banking business work very well. In the last few years the banking business has done very well, and the asset business continues to move along. There is now about $120 billion under management, and they have had consistent growth across different product areas. They are fully diversified by type of client, region, and product, so they are built to withstand any kind of shocks in the system. But there hasn't been much pressure to do things differently because they need to manage earnings.

MR. O'LEARY asked Mr. Fry about the similarities and differences between Lazard and his prior employer, also a large global equity manager. MR. FRY said he wanted to come to Lazard because it is a much more intensely investment-focused organization, and it is a much flatter, faster-moving, more interesting place to work. Even though it is a global organization, it is the right size in the sense that it has the resources to do a global research platform. That was something he really looked into beforehand because he wanted to have confidence that the integrated research capability was there. When he came on board, he was asked to look through the research platform to see how resourced Lazard was, and that is one of the reasons they hired additional people for Asia and Japan. He also looked at risk control and the portfolio construction process; it was all being done but a bit more loosely than it probably should be. So they have been a lot more diligent, all the portfolio managers once a month systematically getting together to run through all the portfolios and talk about the risk issues — what could hurt them, what are they exposed to, why are they taking a bigger bet in one portfolio and not in another, etc.

15. Resolution 2007-20 - FY08 PERS Employer and State Contribution Rate

Staff handed out version #4 of Resolution 2007-20, which combined two resolutions the Board had looked at the day before into one.

CHAIR SCHUBERT said she understood that the Department of Law worked with Commissioner Kreitzer and others to come up with the latest version of the resolution.

COMMISSIONER KREITZER <u>moved that the Alaska Retirement Management Board adopt Resolution 2007-20 relating to the FY08 Public Employees' Retirement System employer and State contribution rate</u>. MS. HARBO <u>seconded</u>.

MR. BARNHILL reviewed the whereas clauses of the resolution that set out the history since 2006 leading up to the Board's proposed action today.

MR. PIHL said that in fairness to the ARM Board he wanted the first whereas clause to be a little clearer as to why the Board did what they did. For example, he wanted the word "using" changed to, "...based on the level dollar funding method, which is required for a closed plan, and using a 25-year period to amortize the unfunded liability; and..." He said the Board has been criticized for creating an unnecessary crisis, and in fairness to what the Board did, it should be clear what they did and why they did it. He proposed that wording as a friendly amendment.

MR. BARNHILL continued with his review of the whereas clauses.

MR. TRIVETTE asked if the State's contribution for the defined contribution retirement plan would be taken out of the 22%. MR. BARNHILL said the State as an employer would pay 22%, and the difference between 22% and the State's actuarial rate as set forth in the 2005 supplement would be made up by withdrawing that difference from the appropriation of $185 million. He added that the 22% would also cover the 5% contribution for the defined contribution requirement under Senate Bill 141.

MR. WILLIAMS told Mr. Trivette that the statutory contribution into the 401K is less than 22%, so the intent is that if the employer is paying 22%, the amount in excess of what is needed to cover the statutory contribution for the defined contribution plan is going to be going into the unfunded liability of the defined benefit plan.

MR. BARNHILL noted that the last whereas clause addresses that point when it states, "...to cover employer contributions for both the defined benefit and defined contribution plans;"

Referring to the second whereas, MR. PIHL asked if SB 123 "requires" or "allows" that employer defined benefit plan contribution rates be calculated upon the full payroll of employees in both the defined contribution and the defined benefit plans. MR. BARNHILL said he thought it was "requires" but did not have the language of the bill in front of him. COMMISSIONER KREITZER said she was fairly certain it was "requires" but she would check.

MR. BARNHILL went on to review the "resolved" clauses in Resolution 2007-20. He noted that the first "resolved" states that the ARM Board adopts the level percentage of pay method for funding the unfunded liability of PERS. It is needed because the Board in the past adopted the level dollar funding method for amortizing the unfunded liability.

MR. SEMMENS thanked everyone who worked on revising Resolution 2007-20 because the result was a very good product.

COMMISSIONER KREITZER asked Mr. Pihl to move his suggested language in the first whereas so the Board could act upon it.

MR. PIHL moved to amend the first whereas clause of Resolution 2007-20 to delete the word "using" in the third line and substitute the words "based on", then after the word "method" include the clause "which is required for a closed plan, and using a 25-year period to amortize the unfunded liability;" MS. HARBO seconded.

The roll was called, and the motion to amend passed unanimously, 8-0.

There was no further discussion on the main motion, and the Chair asked that the roll be called. The vote was all ayes, 8-0.

16. Medical Trust Accounting Update - Resolution 2007-25

MR. BARNHILL indicated that VIRGINIA RAGLE of the Department of Law was listening by telephone and was available to answer questions. He explained that in the wake of Senate Bill 141 the State of Alaska recognized the need for assistance on federal income tax compliance issues, so the Department of Law, together with the Department of Administration, retained Ice Miller as counsel to advise on the whole array of tax issues. Ice Miller observed that Internal Revenue Code requires that contributions for medical benefits be segregated and kept in a separate account from pension contributions. That is not what the State of Alaska was doing, and Ice Miller recommended that the State change that. Part of the technical fix bill, SB 123, set up segregated employer contribution rates, so there is a contribution rate just for medical benefits and a contribution rate just for pension benefits. A new statute AS 39.30.097 authorized the establishment of a separate trust account for health contributions. The resolution before the Board today establishes that account through a trust agreement.

Staff handed out a document entitled "Alaska Defined Benefit Plan Retiree Health Care Trust Agreement," an agreement between the ARM Board and the Department of Administration that was drafted by Ice Miller. MR. BARNHILL said the Department of Law made significant changes, and Mr. Johnson and the Department of Administration, Division of Retirement and Benefits also closely reviewed the document. The retiree health care trust account into which medical contributions will go is set up under section 115 of the Internal Revenue Code. The funds deposited into this account are for the exclusive benefit of the systems' beneficiaries for medical benefits only. Monies cannot be withdrawn from this account and deposited into the pension account, nor can monies be withdrawn from the pension account and deposited into the health care account. So from this point forward the accounts will be accounted for separately, but they will be pooled for investment purposes.

MR. BARNHILL said that the Board heard earlier that the actuaries have done research work to establish what will be the starting balance of this account. The next step before that money is deposited from the pension account into the medical account is to seek permission from the Internal Revenue Service to do that. That work is underway, and hopefully before the end of the calendar year the IRS will give its approval.

MR. BARNHILL stated that the trust agreement establishes the ARM Board as the trustee of the new health care account and the Department of Administration as the administrator of the account. The agreement sets forth respective duties and responsibilities, which are identical to the duties and responsibilities of the ARM Board and the Department of Administration set forth in statute.

COMMISSIONER KREITZER <u>moved that the Alaska Retirement Management Board adopt Resolution 2007-25, adopting the Retiree Healthcare Trust Agreement (effective July 1, 2007)</u>. MR. PIHL <u>seconded</u>.

MR. O'LEARY asked if assets of a trust of this nature could be commingled for investment purposes with pension assets. MR. BARNHILL said yes, that the statute that was passed in SB 123 explicitly says that.

MR. WILLIAMS commented that he believed it was also permissible under Internal Revenue Code.

MR. BARNHILL explained that the key is whether the assets are qualified assets under section 401 of the Internal Revenue Code.

MR. BADER stated that it was certainly the desire of the Department of Revenue that these assets be pooled. But right now staff does not know what is going into the retiree health care trust fund, what the contribution rate will be, whether there will be a transfer of assets, or whether any contribution determined jointly between the Department of Administration and the Department of Revenue will be sufficient to pay the medical payments. Staff has been looking at the potential ramifications of this health care trust, and they heard the actuary say yesterday that the National Guard and Naval and Militia Retirement System should not have an earnings assumption of 8.25% when it is invested in highly liquid investments. The only thing that staff knows for sure is that there will be contributions coming into the retiree health care trust fund. If that is all that is in the pool, it will have to be invested in highly liquid investments. If that is the case, then the current asset allocation for PERS and TRS does not have that sort of liquidity. If every contribution were to go into the retiree healthcare trust, then making pension payments would effectively pay down or exhaust the pension trust. MR. BADER said this did not bear on the action before the Board today, but Department of Revenue staff would have to work closely with the Division of Retirement and Benefits so the strategies used for contributions do not adversely affect that asset allocation. It may turn out that staff will need to come to the Board with an asset allocation for the healthcare trust and an asset allocation for the pension trust.

MR. JOHNSON informed the Board that the point Mr. Bader brought up was addressed, in part, in the second to the last "be it resolved" clause in the resolution the Board just adopted *(Resolution 2007-20)*.

MR. BARNHILL said that to the extent that it appears evident that segregating these accounts for tax purposes is going to adversely affect asset allocations, legal counsel should know that so they can present that to the IRS and seek some sort of exemption. From his perspective, the State is doing what it can to satisfy the IRS, but it should not adversely impact how the money is invested, so that complying with what is supposed to be a protective rule from the Internal Revenue Code actually hurts the systems and beneficiaries of the systems. That turns the whole point of the trust agreement on its head.

MR. BADER stated that he had discussions with Mr. O'Leary and the IAC members this morning about how to approach this issue. Until staff knows what is going to be in the retiree healthcare trust fund, any reaction is mere speculation. Staff sees some options that would not necessarily be adverse, but the options would require a different way of doing business. Staff needs more facts first.

MR. TRIVETTE commented that there is a limited amount of money for retiree healthcare, and the Board wants to make sure it gets the best possible investment returns. So if there are any unintended consequences of creating a retiree healthcare trust, then the Board will have to look at it again, even if it means going back to the IRS. He encouraged staff to poll Board members if action is needed between regularly scheduled meetings.

The roll was called on Resolution 2007-25, and the vote was unanimous, 8-0.

17. Asset Allocation - Medical Trust Fund

MR. BADER indicated that staff was passing out an action memorandum and resolution related to the retiree healthcare trust fund just established by the Board in Resolution 2007-25. The Board has stewardship over any amounts of money in the healthcare trust fund, so it is appropriate to establish an asset allocation, although the policy will be amended as soon as the two departments can establish what is in the fund and what contributions to expect. He said staff believes all the money should be put into a cash account until the amount of assets in the fund is clearly established. The assumption is that the assets in the retiree healthcare fund will soon be needed to pay beneficiary health payments. This will give staff time to prepare a comprehensive asset allocation plan for the Board to consider at the September meeting.

MS. HARBO moved that the Alaska Retirement Management Board approve Resolution 2007-26, adopting the asset allocation for the retiree healthcare trust fund as 100% cash. MR. TRIVETTE seconded.

MR. SEMMENS inquired if the $185 million appropriation by the Legislature expected to come in on July 1, 2007 would impact the retiree healthcare trust account. MR. BADER said that if the $185 million were to all come into the retiree healthcare trust, it would be invested in cash. By that time, staff would have some idea of what the cash flows would be, and if they were not going to be large, the asset allocation could be changed to have longer-term investments. He reminded the Board that there is an account in the Department of Revenue that holds assets for paying medical benefits. The last discussion he had with Christina Maiquis at the Division of Retirement and Benefits was that this fund would probably be drawn down prior to actually accessing the healthcare trust. But staff has not sat down with DR&B, the Department of Law, and consultants to review this. He said that cash is not a bad investment right now because the yield curve is fairly flat, so it is a reasonable approach to take for the next three months.

MR. RICHARDS said that the Board heard that there might be an allocation of pension funds going back to 1975 that could be moved into the retiree healthcare trust fund. He thought that could happen quickly if the IRS gave approval to the Department of Law to move some amount of money over. He didn't think those assets should all be converted to cash, in that event.

MR. BADER agreed that if there was a movement of illiquid investments before the Board had a chance to meet, there would probably be a teleconference meeting to establish another asset allocation, because staff would not be liquidating illiquid investments. But all he was anticipating right now were contributions to the retiree healthcare trust fund.

MR. TRIVETTE said the Board mainly has to make sure there is enough money available to pay medical claims while everyone works out the intricacies of the trust fund. MR. BADER replied that if the account holding assets for paying medical benefits is accessed first, there is plenty of money available to last until the September board meeting.

MR. PIHL asked if staff could leave the investments the way they are until the allocation is worked out and maintain an intra-fund balance between health benefits and pension benefits. MR. BADER said the answer was a qualified yes. It was qualified because there is the same asset allocation for pooled assets between PERS and TRS. However, these funds have billions of dollars in them, and staff is constantly rebalancing between PERS and TRS because the TRS funds are drawing assets down at a greater rate than the PERS funds. Staff does not know how big the assets will be for the retiree healthcare trust fund, and all he was aware of were the contributions into the trust. That is why he was not recommending a diversified asset allocation for the healthcare trust until the issue is resolved.

MR. WILLIAMS observed that the resolution before the Board was a short-term solution for the employer contributions that come in beginning July 1, which have to be split between pension and healthcare. So it will be a small amount of money until the State hears from the IRS about how to carve up the pension assets already invested.

The motion passed unanimously, 8-0, on a roll call vote.

UNFINISHED BUSINESS

1. Adopt Proposed 2008 Meeting Calendar

MS. HALL distributed a revised 2008 meeting calendar that incorporated changes made at the last meeting and asked for Board approval.

MS. HARBO <u>moved that the Board adopt the 2008 meeting calendar</u>. MR. RICHARDS <u>seconded</u>. The motion passed without objection.

2. Disclosure Reports

MS. HALL indicated that the list of disclosures for individual investment transactions made by trustees and staff was included in the meeting packet.

3. Legal Report

MR. JOHNSON stated that this might be his last meeting as the Board's legal counsel, but he would be happy to participate in the transitional process. He thanked the trustees and staff for the opportunity to work with them — some of them for a long time — and said it had been a genuine pleasure.

MR. TRIVETTE thanked Mr. Johnson for his work for this Board and other boards over the years.

He said that as a trustee and as a PERS retiree, he would like to see Mr. Johnson continue on as the legal counsel, if that was in any way possible. He said he attended PERS and TRS board meetings for years before this board was established and knew the value of Mr. Johnson's helpfulness to anyone who had questions.

CHAIR SCHUBERT said she had not originally voted for Mr. Johnson's firm when the Board made the decision to hire him as outside legal counsel, but she had full faith and confidence in him now.

MS. HARBO said she echoed Mr. Trivette's comments because she found Mr. Johnson was a walking encyclopedia and/or historian for the State of Alaska pension systems. She hoped the Board could keep him around.

MR. BARNHILL stated that the Department of Law thinks the world of Mr. Johnson and wished to express their highest appreciation for his many years of terrific service to the State in multiple capacities, including as legal counsel to the various boards in the pension context. He then gave an update on the Department of Law's recruitment process for a new senior assistant attorney general intended to serve as legal counsel for the ARM Board, the Treasury Division in the Department of Revenue, and the Alaska Permanent Fund Corporation (APFC) and its board. He said that following the interview process, both the APFC and the Department of Revenue expressed concern that the work from both entities would overwhelm one attorney position and that there was enough work to warrant hiring two attorneys. The Department of Law is in discussions with the APFC and the Department of Revenue about their willingness to fund two senior assistant attorney general positions within the Department of Law. He said it was prudent to extend Mr. Johnson's contract past June 30 on a transitional basis, with the intention that the Department of Law will conclude the recruitment process well before the September meeting.

MR. BARNHILL said there have been discussions about pursuing a lawsuit against the retirement system's former actuary. The Department of Law sought funding from the Legislature this past session to hire a law firm from New York City experienced in this area. The Legislature did not fund that litigation. In the wake of that, the law firm has now offered to handle the matter on a full contingency fee basis, including paying for all the costs. The Department of Law is in the process of finalizing that agreement with the law firm.

NEW BUSINESS

Health Care Subcommittee of the Board

COMMISSIONER KREITZER said she has been approached about coverage for various illnesses and potential changes to the health care plans. She said she did not want to make any decisions in a vacuum and so was asking the Chair to establish a subcommittee to vet some of the issues that have been brought to her attention. She said that Commissioner Jackson of the Department of Health and Social Services has expressed an interest in working with the Department of Administration in any kind of a wellness program.

CHAIR SCHUBERT asked Mike Williams who else was on the previous Health Care Committee that he chaired. MR. WILLIAMS said Ms. Harbo and Mr. Trivette. CHAIR SCHUBERT asked Commissioner Kreitzer to serve on the committee and invited any other trustees who wanted to be on the committee to indicate their interest. There were no others.

COMMISSIONER KREITZER indicated that the committee would schedule a meeting and issue public notice.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS - None.

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. MITCHELL thanked the board as a whole and each individual trustee for renewing his contract on the IAC.

MR. WILSON noted that staff's reports, Mr. O'Leary's presentations, and the opinions of outside experts all contain a continuing theme to think about the allocation to international stocks and how to go about that. He urged the board to think about it but with a deliberate pace. Given the returns for international stocks over the last five years, the performance is sure to reverse just as the board considers a change.

TRUSTEE COMMENTS

MS. HARBO congratulated and thanked the Department of Revenue's terrific team for another great quarter of earnings.

MR. PIHL said he echoed the earlier comments about Rob Johnson and that it had been a pleasure. He noted that the Board received a summary of the expenditures for actuarial services. He asked whether the ARM Board was going to pay for all of it or if part of the cost was allocated to the Department of Administration or the Office of Management and Budget. He said it seemed like a lot of the work was beyond what he would allocate to the pension fund. He said he hoped that would be looked at.

CHAIR SCHUBERT thanked David Teal of Legislative Finance for his assistance with some of the tough issues the board dealt with at this meeting.

FUTURE AGENDA ITEMS

MR. TRIVETTE said he supported Mr. Pihl's comment about the actuarial expenditures and wanted to see it as a future agenda item. He said it might be that every penny is appropriate for the pension fund, but it might not. He recalled a 2005 letter from Deloitte & Touche regarding how the money could be spent based upon Alaska law at that time, and he did not think there was anything in SB 141 that changed that guidance.

ADJOURNMENT

THERE BEING NO OBJECTION AND NO FURTHER BUSINESS TO COME BEFORE THE BOARD, THE MEETING WAS ADJOURNED AT 4:40 P.M. ON JUNE 14, 2007, ON A MOTION MADE BY MS. HARBO AND SECONDED BY MR. WILLIAMS.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Gayle W. Harbo

Corporate Secretary

Note: The summary minutes are extracted from a tape recording of the meeting and are prepared by an outside contractor. For in-depth discussion and more presentation details, please refer to tapes of the meeting and presentation materials on file at the ARMB office.

Confidential Office Services
Karen Pearce Brown
Juneau, Alaska