State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
SPECIAL TELECONFERENCE MEETING

Location of Meeting
11th Floor Treasury Conference Room, State Office Building
Willoughby Avenue, Juneau, Alaska

MINUTES OF
July 25, 2008

CALL TO ORDER

CHAIR GAIL SCHUBERT called the meeting of the Alaska Retirement Management Board (ARMB) to order at 10:00 a.m.

ROLL CALL

Six trustees were present at roll call to form a quorum.

ARMB Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo
Commissioner Annette Kreitzer
Martin Pihl
Tom Richards
Larry Semmens
Mike Williams (joined at 10:45 a.m.)

ARMB Board Members Absent
Commissioner Patrick Galvin

Department of Revenue Staff Present
Brian Andrews, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Scott Jones, Assistant State Comptroller
Zach Hanna, State Investment Officer
Ryan Bigelow, State Investment Officer
Judy Hall, Board Liaison

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

Investment Advisory Council Present
Dr. Jerrold Mitchell
Dr. William Jennings

Others Present
Michael O'Leary, Callan Associates, Inc.
Rob Johnson, board legal counsel
Mike Barnhill, Department of Law
Ricki Markscheffel, Dept. of Transportation, Ketchikan

PUBLIC MEETING NOTICE

JUDY HALL confirmed that public meeting notice requirements had been met.

APPROVAL OF AGENDA

GAYLE HARBO moved to approve the agenda. SAM TRIVETTE seconded.

The agenda was approved as presented.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

RICKI MARKSCHEFFEL, an employee of the Alaska Department of Transportation, Construction Section, in Ketchikan, said she hoped to retire in about 4-1/2 years. She referred to a July 12, 2008 letter that she sent to the Board in which she expressed concern about the safety of the money held in the SBS (Supplemental Benefit System) and the Deferred Compensation Plan (DCP). She was specifically concerned about the potential problems within the lowest risk options: the Interest Income Fund and the Stable Value Fund appear to be exposed to the current derivative crisis through what are called synthetic investment contracts. She said these options are no longer low risk, given the current global financial situation. The financial framework of the past 40 years is collapsing, and new options need to be created in a new framework. She understood that just holding money without any investment does not allow for keeping up with inflation, and at this time there is not a foolproof way to keep up with inflation, other than gold. Until the world financial markets settle down, which she thought was a few years away, she preferred a mechanism to at least preserve the money currently in her SBS and Deferred Compensation Plan accounts. The DCP account was of particular concern because she considered the principal monies in the account to be wages still due to her. She wanted those wages to stay in that account and be held in such a way that the value cannot "go negative." She asked if the State can make this program safe to where deferred wages cannot disappear. If not, then would this be an appropriate time to dissolve the program so that individuals can take possession of their deferred wages rather than watch the wages disappear?

MS. MARKSCHEFFEL said she was pleased that the ARM Board was working to seek other investment options for SBS, Deferred Comp, and the defined contribution retirement plan. She encouraged the Board to seek a truly low to no-risk option for people who wish to stay out of the general markets. She asked if a mechanism could be provided to move funds to cash or perhaps into Treasury bills. Perhaps an option offering Treasury bills could be considered as a safety net or a holding tank for crisis periods such as this. She said her next comment might appear to be contrary to the idea of safe, however, she looked for investment options more suited to the current financial climate. It appears that the market is in a strong commodity cycle, which was predicted and which is also predicted to last another 12 to 16 years. Therefore, she wanted to see investment choices with exposure to commodities, including resources and precious metals, and exchange-traded funds (ETFs) for gold and silver. That might sound too drastic and contrary to her idea of safe, but she was hoping that new investment choices would consider these areas, given the current global financial situation.

MS. MARKSCHEFFEL thanked the Board for allowing public comment and for their work on participants' behalf.

MR. TRIVETTE indicated that he had a copy of Ms. Markscheffel's letter. He urged her to stay on line and listen to the rest of the meeting, and to also get a copy of the meeting materials from ARMB staff. He said the Board, staff, and consultants have been working on investment options for going on two years.

MS. HARBO thanked Ms. Markscheffel for taking the time to testify and for writing a letter outlining her concerns.

DEFINED CONTRIBUTION PLAN COMMITTEE REPORT

Chair of the Defined Contribution Plan Committee, SAM TRIVETTE, gave a brief report on what they have done that has led to the staff presentation at this meeting. He praised everyone who has worked on this project.

PARTICIPANT-DIRECTED PLANS - NEW OPTIONS

Chief Investment Officer GARY BADER stated that the committee's most recent work centered around providing options to participants that address many of the items that Ms. Markscheffel pointed out in her comments. There is a specific desire to provide safer options than what are currently perceived to be available, as well as options that provide an opportunity to more broadly diversify a participant's holdings. The committee's work was scheduled for presentation to the Board in June, but there were issues that needed to be resolved with custodians. There are participants who are uneasy with the current menu of investment options and who frequently communicate with the Department of Administration. The Board is holding this special meeting to address these issues.

State Investment Officer STEVE SIKES presented a proposed plan to improve the suite of investment options for all the participant-directed plans: the new defined contribution retirement plan, the Deferred Compensation Plan, and the Supplemental Benefits System. *[A copy of the slide presentation is on file at the ARMB offices.]*

MR. SIKES described the committee's process that included establishing structural and investment option goals, evaluating the current options, and identifying appropriate complementary new options. The goals were to: (1) provide a complete suite of investment options in each plan; (2) obtain the lowest fees possible; (3) a preference for passive investments; (4) transparency; (5) options should be understandable; (6) avoid options that would overly concentrate risk exposure; and (7) overall to build the best participant-directed plan possible for beneficiaries.

MR. SIKES presented a matrix of all the investment options that are currently offered to the three participant-directed plans (slide 4). The current suite of options is adequate, but the depth and breadth of options can be improved by increasing the use of low-fee passive options, by providing options with a lower risk profile - such as cash and U.S. Treasury bonds, by building out the option suite to look more like what the ARM Board is doing in the defined benefit plans, and by improving the consistency of offerings across plans.

MR. SIKES then reviewed the new investment options that the DC Plan Committee was recommending to the Board. The new options would be added to all the participant-directed plans. In the cash category there would be a Treasury Money Market Fund that would invest in U.S. Treasury securities with a maturity of 397 days or less. A Russell 3000 Index fund and a Wilshire REIT Index fund would be added to the domestic stocks category. The latter would provide some real estate exposure because the ARM Board invests in real estate in the defined benefit plans. In the international stocks category a MSCI All Country World ex-US Index fund is being proposed to provide a passive international broad market option. This option would include approximately 18% of emerging market exposure. Within domestic bonds the recommendation is to add a Lehman long U.S. Treasury index fund that would invest in maturities greater than ten years and offer yield and safety to participants. The second addition in the domestic bond category is a Lehman Treasury Inflation Protected Securities Index fund (TIPS) to provide participants the ability to hedge inflation. A World Government Bond ex-US Index fund is proposed for the international bonds category to add portfolio diversification. Lastly, the suite of balanced and target date funds would be expanded to include the Alaska 2010 Retirement Trust, which would essentially pick up where the current 2010 target date fund is gliding to. This will allow pending retirees to redeploy in an asset allocation that is designed for their retirement profile. The Alaska Target 2030, 2035, and 2040 trusts are additions to provide a

40-year target horizon for beneficiaries.

MS. HARBO asked if the DC Plan Committee considered GNMA funds. MR. BADER replied that they did not because GNMAs are viewed as a subset of some other funds that are currently offered.

Responding to MS. HARBO's comment about costs, MR. SIKES stated that the proposed new options, with the exception of the target date funds, are passive index options that come with very low fees.

MR. TRIVETTE explained that offering the MSCI ACWI ex-US Index fund for international stocks was an effort to get emerging markets exposure in an investment option. He thought that was a major improvement.

MR. SIKES stated that because the Treasury Money Market Fund is investing in short Treasuries and bills and notes, it is not technically an index fund either.

MR. SIKES described how, in addition to the new options, the proposal is to fill out existing investment options that are not currently offered to all plans. For example, the Intermediate Bond Fund is currently available only in the Deferred Compensation Plan, and several of the target date and balanced funds are not offered in all plans.

MR. SIKES noted that with the adoption of the Treasury Money Market Fund there will be a requirement for a trading restriction called an "equity wash." MR. BADER explained that the Stable Value Fund in SBS and the Interest Income Fund in the Deferred Compensation Plan hold portfolios of fixed income investment-grade securities. Generally, the fixed income securities pay a set amount of interest periodically and at some future date return the original investment to the owner of the security. The underlying securities held by the ARMB custodian are on the ARMB's behalf and are not investments held in the name of insurance companies or banks. Because interest rates change from time to time, the value of the fixed income securities the ARMB holds change. So there is volatility, even in holding fixed income securities. The stable value fund enters into contracts with outside financial intermediaries (banks and insurance companies) to provide a "wrap contract." The wrap contract essentially provides a mechanism so that the market value of the security is smoothed in recognizing the market gains and losses over a period of time. However, if interest rates suddenly shifted much higher, everybody would want to get out of stable value in favor of something like a money market fund. But banks and insurance companies that are promising to keep the value of the fund at a certain amount know that everyone will shift to the short-term interest rate type of investment, so they require in their contracts what is called an equity wash. The equity wash states that a person can get out of stable value but cannot go directly into one of the fixed income type of accounts. So a person would have to invest in one or more eligible investment options that is not considered a competitor of the stable value type fund and stay there for 90 days before putting the money into a competing fund.

MR. BADER said the Board has a choice, if they do not want to have an equity wash, to get out of stable value. However, stable value is one of the most popular investment options: $145 million in Deferred Comp is in the Interest Income Fund, and over $200 million of SBS money is in the Stable Value Fund. Both funds operate the same. Staff proposes to have the equity wash so that there are a number of shorter-term fixed income investment alternatives available to everyone to meet their financial needs.

At Mr. Bader's invitation, MR. O'LEARY offered his comments. He said many plans have moved away from having the administrative hurdle associated with offering both a money market type of alternative and a stable value alternative. In recent years, plans have moved toward the stable value option. The credit concerns of the last 12 months have caused some plans to think that maybe it is worth the hassle of having the administrative requirement of an equity wash. He said he was quite comfortable with the staff recommendation because there are participants, such as Ms. Markscheffel, who really value the security of a short-term government instrument and are willing to sacrifice return in order to get that. However, it is a communications challenge, as is the volatility that is associated with the other fixed income options that are proposed additions. For example, the volatility of plus or minus 9% in the International Bond Index Fund is not at all unusual. Even the Treasury Inflation Protected Securities Index and the Lehman Long U.S. Treasury Index are volatile funds and so present a communications challenge.

MR. O'LEARY stated that there are two different imbedded risk tolerances with respect to having both the Money Market Fund and the Stable Value Fund, and he encouraged the Board to offer both investment options.

MR. SEMMENS asked how the equity wash requirement impeded or facilitated Ms. Markscheffel's concerns. He thought that, if given the opportunity, Ms. Markscheffel would immediately want to move monies that she may have in the Stable Value Fund into the Treasury Money Market Fund, and it seemed that she would not want to be exposed at this time to the 90-day equity wash requirement. He asked if the Board should consider a 30-day or 60-day or some period of time at the beginning when the equity wash requirement would not be in place so people with concerns could do what they wished to do.

MR. O'LEARY replied that the ARM Board has an obligation to those participants who continue in the Stable Value Fund, and the equity wash requirement is, in effect, imbedded in the existing contracts. He clarified that the participant does not necessarily move into an equity instrument; they could move into a balanced vehicle or a longer-duration bond portfolio.

MR. BADER stated that if the Board ultimately adopts the recommendation, it will be incumbent upon the Division of Retirement and Benefits (DRB) to begin the notification process on their web site so that people are aware of the impending changes. It obviously cannot be implemented overnight, but DRB and Great-West and the providers of these investment options are all ready to accomplish it, once the Board has given approval.

MR. BADER noted that statutes require that the Commissioner of Administration be consulted on the changes being proposed. For the record, the Defined Contribution Plan Committee Chair Sam Trivette and staff did meet with Commissioner Kreitzer.

COMMISSIONER KREITZER stated that she held an in-depth discussion with Treasury Division staff about the proposed new investment options and agreed with adding them.

MS. HARBO mentioned that many plan participants do not check the DRB web site regularly and so would not see the notification that Mr. Bader said would be posted there. She asked how soon participants would be notified by mail, after the Board takes its action.

DRB Director PAT SHIER said the division appreciated early notification from the Treasury staff so they could start discussions with Great-West and the investment providers.

KATHY LEA, DRB Benefits Manager, stated that the Division has already notified Great-West so they have some processes in place. Great-West expects to do what they need to do in a couple of weeks, and the Division plans to deal with written notification to members within 30 days - as well as on the web site as soon as the Board makes a decision.

Responding to MR. PIHL about the risk of making big changes based on interest rate assumptions, MR. BADER said staff does not advocate trying to forecast the direction of interest rates.

MIKE BARNHILL, Assistant Attorney General in the Alaska Department of Law, inquired about the mechanics of moving from the Stable Value Fund or Interest Income Fund into the proposed Money Market Fund, and if the participant would have to make two change orders on the internet or if it would happen automatically. MR. BADER said he and Ms. Lea discussed equity washes with Great-West and understood that participants are not required to go into an equity account. The prohibition would be against going from the Stable Value Fund into a fixed income account that has a duration of less than three years. Staff anticipates that participants would be barred from going into the Treasury Money Market Fund, the Intermediate Bond Fund, and perhaps the Government/Credit Bond Index Fund. He added that he understood that the participant would have to take two actions to make the change Mr. Barnhill described.

MR. BARNHILL said there is a communication burden being placed on DRB staff to help participants understand how it all works because this is a radical change from the current process where a participant can move their investments on a daily basis. To have to transfer money in two steps over a period of 90-days, in order to make a change in investments, is a significant change.

MR. BADER made it clear that participants would not be barred from moving from the Balanced

Fund directly to an Alaska Target Trust, for example. The restriction would only apply for movements out of Stable Value or Interest Income Funds into the Treasury Money Market Fund or some bond funds.

MR. SEMMENS asked if every move out of the Stable Value Fund into another option would be higher on the risk scale than stable value. MR. BADER said that would be true generally, but participants could look at some target date funds that have very short targets: a large percentage of the Alaska Target 2010 Trust is currently invested in money markets, but there is an equity component as well. A participant might find among the current investment options on the menu some that, in their judgment, have a lower risk profile than stable value - but that is debatable.

MR. SEMMENS recalled that Ms. Markscheffel indicated in her testimony that the Stable Value Fund carries more risk than she wished to be exposed to. But the Board is looking at a structure that likely will have more risk to get to a position that Ms. Markscheffel thinks is less risk. MR. BADER agreed that was a fair statement for the short run, but a participant has the choice to stay in the Stable Value Fund.

MR. SEMMENS said the Board may be criticized for not providing a mechanism for participants to get directly from the Stable Value Fund to what they may perceive to be the less risky Treasury Money Market Fund option. He thought Mr. O'Leary had said that allowing that direct move would adversely impact the people still invested in the Stable Value Fund. He said that any participant can leave the Stable Value Fund currently and go to a more risky option, and the impact on those people still in the Stable Value Fund would be exactly the same. He wished there was a period of time, however short, when participants would be able to make the direct move to the money market option. He said he understood that not knowing what interest rates will do, the ARMB could be creating an improper opportunity as Mr. Bader described earlier.

MS. HARBO noted that participants could opt to put any new contributions into the Treasury Money Market Fund or any other of the new options.

MR. O'LEARY stated that participants will be able to move any other program assets they have, other than Stable Value Fund assets, to the Treasury Money Market Fund. Theoretically, they could also move their Stable Value Fund assets to the fund from which they moved money to go into the Treasury Money Market Fund. People cannot be advised to do that because it is making an end run around the contractual requirement, and it does not help the participant who is one hundred percent in a stable value type fund currently.

MR. RICHARDS suggested that a participant be allowed to earmark a quantity of money in their Stable Value Fund account for movement to the Treasury Money Market Fund, and they would be subject to a 90-day waiting period after which the money would automatically be transferred. The participant would not have to make two transactions and go to a potentially more risky equity option for 90 days. And maybe the 90 days could be reduced to 60 days, unless the 90 days is a legal requirement.

MR. BADER thought it was still a fixed income vehicle with an interest earning of zero, which is a duration that is still less than three years, and therefore in violation of the contract.

MR. BARNHILL asked if setting up a cash account for the transfer would pose the same problem. MR. BADER said he believed it would.

MR. PIHL referred to a March 31, 2008 performance report showing the Stable Value Fund was a better performer in the two previous quarters than almost any other investment option available to plan participants. He said the Stable Value Fund has served a good purpose and he hoped people were not picking on it too much.

MS. HARBO added that people need to be looking at the long term and not just at the last three months or a year. MR. PIHL said the since-inception return for Stable Value is 4.28%, which is more than about half of the other options for the same time frame.

MR. O'LEARY said the expectation is that over the long term the Stable Value Fund will generate a higher rate of return than a money market fund. It also provides the participant with reasonable assurance that the value of the investment will remain intact. It is not a guarantee, because there are scenarios where there are negative earnings arising from credit problems in the underlying fixed investments. Even if some such problems were to occur, they probably would just result in a reduction in the earnings rate. There is nothing wrong with stable value as an investment vehicle. If a participant were to die tomorrow, their estate would be paid out the value of the account immediately.

MR. TRIVETTE stated that after hearing everybody's input on this, he was comfortable with the equity wash requirement.

MR. PIHL said he assumed the retirement system will pay for what he thought would be the substantial cost to implement the proposed investment option changes. MR. BADER replied that SBS, Deferred Compensation Plan, and the defined contribution plans in the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) will bear the cost of the proposed changes. The State general fund should not be involved at all.

The Board's legal counsel, ROB JOHNSON, stated that the notice from DRB to the beneficiaries deserves a separate page with big red letters to describe the funds and the restrictions on withdrawals. MR. BARNHILL agreed that was an excellent point and added that the notice should be sent out on a periodic basis.

MR. TRIVETTE stated that the Defined Contribution Plan Committee considered other changes to the plans that they decided not to put forth at this time (slide 10). He said those things were as important as what the Committee eventually included in its recommendation to the full Board. He thanked staff and the consultants for having an open mind and looking at other investment options that at this point do not appear to be feasible.

MR. RICHARDS mentioned that many plan participants have not actively selected where their money will be invested and so have been placed in the default option. He asked what would happen to participants to get them to make an active decision or if they would be placed in all passively managed funds.

MR. BADER said that if a participant is in the new defined contribution retirement plans and they fail to make a selection, their funds are being invested according to Great-West's Managed Account program that DRB has in place until July 1, 2009. The Deferred Compensation Plan does not have a default option: participants must select an investment option. SBS participants who do not make a different investment election are invested in the Alaska Long-Term Balanced Trust, which is actively managed in what is actually an enhanced index fund. Staff has discussed with the fund's manager, T. Rowe Price, the standards for drift away from the index so that Treasury staff can recognize if T. Rowe Price is more actively managing this fund than anticipated. This manager has a history of tracking the index very closely.

Speaking by teleconference, MR. WILLIAMS indicated that he missed the staff presentation earlier but, as a member of the Defined Contribution Plan Committee, he was fully familiar with the material and supported the recommendation to the Board.

ACTION: RESOLUTION 2008-26

MR. BADER drew attention to the staff memorandum "New Options for Participant Directed Plans - Resolution 2008-06," which summarized the presentations made today and included a recommendation to add the proposed new options for all participant-directed plans; to permit all plans to invest in the Intermediate Bond Fund, Alaska Balanced Trust, and Alaska Target Date Fund; and to implement the equity wash program.

MR. TRIVETTE moved that the Alaska Retirement Management Board adopt Resolution 2008-26, which is intended to add the proposed new options (described in the memorandum) to all participant-directed plans, to permit all plans to invest in the Intermediate Bond Fund, Alaska Balanced Trust, and Alaska Target Date Funds, and to implement the "equity wash" program. MS. HARBO seconded.

Roll call vote
Ayes: Harbo, Kreitzer, Pihl, Richards, Semmens, Trivette, Williams, Schubert
Nays: None

The motion passed unanimously, 8-0.

CHAIR SCHUBERT thanked the committee members and the staffs of the Treasury Division and the Retirement and Benefits Division for their hard work on this item.

ACTION: CONTRACT AMENDMENTS

MR. BADER reviewed the staff memorandum that described how staff carried out the Board's February 15, 2008 direction to change the asset class designations to six broad categories: domestic equity, foreign equity, fixed income, real assets, private equity, and absolute return. Staff also recommended expanding the number of funds accessing the asset classes to include the PERS and the TRS health trusts, the defined contribution medical funds, health reimbursement arrangement fund, and the PERS/TRS occupational death and disability funds. The intent is to invest for those plans similar to how the larger PERS and TRS funds are invested. At its April 25, 3008 meeting, the Board approved the asset allocation for the fiscal year starting July 1, 2008.

MR. BADER stated that as staff was implementing the new asset classes and allocations they determined that certain of the Board's investment manager contracts would need to be amended to allow the new funds to access established pools. Some of the investment manager contracts state that "ARMB is the fiduciary of assets of the PERS and TRS trusts." This limits expanding the number of funds accessing all the asset classes, which the Board approved doing at the February meeting. Staff consulted with Board attorney Rob Johnson, and they believe the contract language can be broadened to say that *"ARMB hereby appoints the contractor as investment manager of all securities and cash received by it from or on behalf of trusts under the fiduciary responsibility of ARMB."* Staff believes the amended contract language will provide a step forward in entering into contracts on behalf of the ARMB and that it does not limit investments to only PERS and TRS accounts. Staff has been in frequent contact with Mr. Johnson and Mr. Barnhill about being efficient in how the funds are pooled together and at the same time being in compliance with tax laws and securities laws, etc., while keeping accounting requirements in mind. The recommendation is that the Board authorize staff to proceed with any necessary amendments to investment contracts.

MR. SEMMENS moved that the Alaska Retirement Management Board authorize staff to proceed with amendments to the investment contracts deemed necessary and appropriate. MS. HARBO seconded.

Roll call vote
Ayes: Williams, Trivette, Semmens, Richards, Pihl, Kreitzer, Harbo, Schubert
Nays: None

The motion carried unanimously.

STATE STREET GLOBAL ADVISORS SETTLEMENT UPDATE

MR. SHIER gave the report because Deputy Commissioner Brian Andrews had been called out of the room.

MR. SHIER reported that this morning he spoke with one of the final two larger recipients of settlement funds and they agreed to sign the release. That brings the amount outstanding from about $60,000 down to $30,000. There are several very small balance members remaining, and Mr. Barnhill and Mr. Worley are discussing with State Street Global Advisors what it will take to extinguish those few remaining.

MR. SHIER stated that Mr. Andrews wanted him to mention that the State general fund burden on this settlement is now zero and that all funds have been received from State Street.

Responding to MR. TRIVETTE, MR. BARNHILL said the remaining 50 or so people have very small settlement amounts. He said he has personally made dozens of calls trying to find these people who have left no forwarding addresses or phone numbers. The next step is to approach State Street to see if they will agree to let the State post the settlements to these people's SBS accounts without receipt of a release. Most of the settlements are less than $500.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/TRUSTEE COMMENTS - None.

ADJOURNMENT

THERE BEING NO OBJECTION AND NO FURTHER BUSINESS TO COME BEFORE THE BOARD, THE MEETING WAS ADJOURNED AT 11:08 A.M., ON A MOTION MADE BY MS. HARBO AND SECONDED BY MR. PIHL.

Sam Trivette

Vice Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary
Gayle W. Harbo

Note: The summary minutes are extracted from staff's tape recording of the meeting and are prepared by an outside contractor. For in-depth discussion and 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