State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location of Meeting
Hickel Room, Centennial Hall
51 Egan Drive, Juneau, Alaska

MINUTES OF
February 12-13, 2009

Thursday, February 12, 2009

CALL TO ORDER

VICE CHAIR SAM TRIVETTE assumed the chair duties at the meeting location in Juneau because Chair Gail Schubert was participating by teleconference from Anchorage. He 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. Commissioner Galvin arrived shortly.

ARMB Board Members Present
Gail Schubert, *Chair (by teleconference)*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Kristin Erchinger
Commissioner Patrick Galvin
Commissioner Annette Kreitzer
Tom Richards
Mike Williams *(by teleconference)*

ARMB Board Members Absent
Martin Pihl

Investment Advisory Council Members Present
Dr. William Jennings
George Wilson

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

Department of Revenue Staff Present
Jerry Burnett, deputy commissioner
Gary M. Bader, chief investment officer
Pamela Green, state comptroller
Bob Mitchell, senior investment officer
Zachary Hanna, state investment officer
Steve Sikes, state investment officer
Victor Djajalie, state investment officer
Casey Colton, state investment officer
Ryan Bigelow, state investment officer
Steve Verschoor, state investment officer
Shane Carson, state investment officer
Bree Simpson, state investment officer
Judy Hall, liaison officer
Scott Jones, assistant state comptroller
Beth Larson, compliance officer
Barbara Siddle
Diane Anderson
Rose Evans
Sharon Gill

Department of Administration Staff Present
Patrick Shier, Director, Division of Retirement and Benefits
Kevin Worley, DRB chief financial officer

Invited Participants and Others Present
Glenn Carlson, Brandes Investment Partners
Juan Benito, Brandes Investment Partners
Ned Notzon, T. Rowe Price
Robert Birch, T. Rowe Price
Charles Shriver, T. Rowe Price
Tony Luna, T. Rowe Price (by teleconference)
William Fornia, Aon Consulting
Mary Beth Redding, Aon Consulting
Senator Bert Stedman
Lisa Terrell, State Street Bank and Trust Company
Mark Schafer, State Street Bank and Trust Company
Dax Johnson, State Street Bank and Trust Company

Neil Tremblay, State Street Global Advisors
Gaurav Mallik, State Street Global Advisors
Blair Thomas, TCW Energy
Claudia Schloss, TCW Energy
Cindy Spanyers, Alaska Public Employees Association/AFT
Jack Kreinheder, Office of Management & Budget

PUBLIC MEETING NOTICE

JUDY HALL confirmed that proper public notice of the meeting had been published.

INTRODUCTION OF NEW BOARD MEMBER

VICE CHAIR TRIVETTE introduced Kristin Erchinger, the chief financial officer for the City of Seward, who was appointed to fill the board seat vacated by Larry Semmens. He noted that Chair Schubert had appointed Ms. Erchinger to the Audit Committee and the Real Estate Committee.

APPROVAL OF AGENDA

VICE CHAIR TRIVETTE added item "E. General Consultant RFP Evaluation Committee" under *13. Investment Actions*. He also indicated that Senator Bert Stedman had asked to speak to the board today and was scheduled to appear following the executive session in the afternoon.

PATRICK SHIER added two items under *3. Division of Retirement & Benefits Report*: "C. Judicial Retirement System FY2010 Rate," and "D. Great-West Billing Changes."

MS. HARBO moved to approve the agenda as amended. MR. RICHARDS seconded. The motion passed without objection.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

The meeting packet contained an email letter from Richard Sewell about the Deferred Compensation Plan's Interest Income Fund and the Supplemental Benefit Plan's Stable Value Fund, and Treasury Division staff's response.

There was no one present in Juneau or on line who wished to speak to the board.

APPROVAL OF MINUTES - December 4-5, 2008

MS. HARBO moved to approve the minutes of the December 4-5, 2008 meeting. COMMISSIONER KREITZER seconded the motion.

MS. HARBO submitted the following corrections: (1) page 5, first paragraph, CPA should be TPA (third party administrator); (2) page 10, third paragraph, "...allocated between the pension benefit systems and Section 1151." should be "...allocated between the pension benefit systems and Section 151."; and (3) page 11, top paragraph, "Ms. Harbo asked for the figure for real estate for the end of October." should be "Ms. Harbo asked for the figure for real assets for the end of October."

COMMISSIONER KREITZER corrected page 47, second sentence in the second paragraph under Trustee Comments, to delete one word: "...regarding compensation to state employees that she will be sending out an email to all ~~senior~~ employees about the geographic differential survey being undertaken;"

The motion passed without objection to approve the December 4-5, 2008 minutes as amended.

REPORTS

1. Chair Report

VICE CHAIR TRIVETTE indicated that he had mentioned his comments earlier. CHAIR SCHUBERT said she had nothing to report.

2. Committee Reports

There were no committee reports.

3. Retirement & Benefits Division Report

A. Membership Statistics/Buck Invoices

Division of Retirement and Benefits chief financial officer KEVIN WORLEY reviewed the membership statistics for the Public Employees Retirement System (PERS) and the Teachers' Retirement System (TRS) for the quarter ended December 31, 2008. He pointed out that the numbers under the "opted out of Managed Accounts" represented those members of the defined contribution plans who had opted out and then have opted back into Managed Accounts.

MR. WORLEY had distributed information to the Board on the October, November and December 2008 invoices from Buck Consultants, the state's actuary.

MS. HARBO asked if Buck's study for House Bill 30 (defined benefit/ defined contribution choices) had been completed. MR. WORLEY said it was in process. MR. SHIER added that the Division supplied a copy of the draft advance bill to the actuary so Buck was aware of it and so the state could schedule Buck's time to do a study, if needed, once the Division was able to identify an appropriate funding source. Another Buck invoice for $1,200 was to update last year's letter in response to Senate Bill 183, comparing the normal cost for the most recent defined benefit tier and the current defined contribution tier for both PERS and TRS. The Division expects the letter from Buck containing the normal costs today. MS. HARBO asked if the board could get a copy of that letter. COMMISSIONER KREITZER said yes.

B. Legislative Update - None.

C. Judicial Retirement System 2010 Rate

MR. WORLEY said that current statute states that the commissioner of administration sets the contribution rate for the Judicial Retirement System (JRS). Attached to a handout was a memorandum from Department of Administration Commissioner Kreitzer setting the actual employer contribution rate for fiscal year 2010 at 26.20%. That rate is based on roll-forward of the June 30, 2006 actuarial valuation report prepared by Buck Consultants. The JRS rate is actually for a two-year period based on actuarial valuation reports done in even-numbered years. The June 30, 2006 rate, however, did not set an FY10 rate. In 2007, Buck did not do a complete valuation report, but they looked at the assets and rolled forward the accrued liabilities based on the assumptions in the actuarial valuation report for 2006. Because the Legislature appropriated $49 million that was deposited into the Judicial Retirement System as of June 30, 2008, that virtually eliminated the unfunded liability for that system. In discussions with Legislative Finance and with DRB staff, they determined that the normal cost rate of 26.20% was appropriate for the JRS as a result of that $49 million general fund appropriation in 2008.

D. Great-West Billing Changes

MR. SHIER reported that DRB is preparing to notify participants in all the defined contribution retirement (DCR) plans in March that the fee schedule charged by the recordkeeper, Great-West, will increase effective July 1, 2009. He said he would share a copy of all the information with the board members once the commissioner has signed off on the communication package, in case participants contact board members with questions. Great-West has been the Division's recordkeeper for about 20 years. They competed and were awarded a new contract in July 2006 for five years, with four additional one-year renewals. The cost of the initial five-year contract term that expires June 30, 2011 was $14,171,070. Great-West implemented the new defined contribution plans at a seven-basis-point fee schedule, even though there were no assets in the new DCR tiers. New DCR participants would be defaulting into Great-West's product called Managed Accounts, which had a significantly higher fee schedule, allowing Great-West to recover its costs over five years. In 2008, the ARMB selected T. Rowe Price target maturity funds as the DCR default option and determined that the Supplemental Annuity Plan default would not change. On June 20, 2008, the Division and Great-West signed an amendment to the contract to reflect that change at an overall cost of $14,171,018. That means the underlying fee that Great-West collects for their services is going from 7 basis points to 14.2 basis points for all participants.

MS. HARBO pointed out that the DC plan participants pay an administrative fee of $35 a year, plus the individual fund fees for the investments they have selected, plus the revised Great-West service fee of 14.2 basis points.

MR. O'LEARY asked if there was an adjustment to the Great-West Managed Account fee. MR. SHIER said no, it would remain the same. He added that the Division expects to renegotiate with Great-West sometime before the July 1, 2011 base contract end date to decrease the overall rate for all participants.

MR. RICHARDS commented that board members may be hearing from plan participants because the higher Great-West service fee will apply to all the participants, once the default option is no longer Managed Accounts. MR. SHIER agreed that the revenue stream that Great-West would have received from the default into Managed Accounts continuing over the rest of the contract is being offset by a general increase in the underlying service fee for all participants.

VICE CHAIR TRIVETTE said he appreciated the verbal report but the board wanted the information in writing as well, in order to deal with phone calls from participants. He added that Great-West's fees for Managed Accounts is much higher than T. Rowe Price's fees for the target maturity funds, which was one of the reasons the board decided to change the default option.

MR. BADER clarified that the difference in fees gained by switching the default option to T. Rowe Price was investment management fees, not recordkeeping fees. VICE CHAIR TRIVETTE responded that he had not expected Great-West's recordkeeping fees to double as a result of the change. MR. BADER said the two things were not related. VICE CHAIR TRIVETTE said the 14.2 basis points service fee that Great-West will be charging as of July 1, 2009 seems to be on the high end, but the board will be getting more information on that in the next year.

MR. SHIER explained that DRB had considered whether to issue another request for proposal because the landscape had changed. But because an RFP had been issued not many years prior, and in consultation with the Department of Law and General Services, the Division thought it unwise to expose the state to a lawsuit for recovery of upfront costs that Great-West had invested. The amended contract appeared to be a good compromise, knowing that DRB would then have an opportunity to renegotiate those rates or perhaps even go out for a new RFP once the five-year contract with Great-West has run its course. MR. SHIER promised to provide the communication package to all board members, and, conditional on maintaining confidentiality, some of the background information for renegotiating the fees.

COMMISSIONER GALVIN observed that what Mr. Shier reported was part of a sequence of events the board set in motion when it changed the default option for defined contribution retirement accounts to target date funds effective July 1, 2009. The Division had negotiated a bundled contract with Great-West in 2006 based on what the overall work for the State would be. So while Mr. Bader indicated these were separate issues, Great-West increasing its underlying service fee for all plan members is not an unexpected consequence. In the grand scheme of things, this additional cost is acceptable, given that the board is providing participants more flexibility in choosing investment options.

4. Chief Investment Officer Report

Chief Investment Officer GARY BADER introduced Steve Verschoor and Shane Carson, two new staff members in the equity section. He noted that board members could read the items in his report, and he would highlight just a few.

Hedge fund transparency: In the wake of the Bernard Madoff scandal, there have been public requests to disclose the names of the limited partnerships that the ARMB is participating in. When the board first entered the hedge fund asset class the top managers were in a position to require in their contracts that investments in the funds be kept confidential. Consequently, staff denied the recent requests for information. Staff believes there may no longer be any particular value to keeping hedge fund investments confidential and that the ARMB needs to work in the direction of providing greater transparency to the public and to the retirement plan participants, in order to keep their confidence in the work of the board. With the board's permission, staff will work with the investment advisors to provide greater transparency, and hopefully a year from this date the ARMB will have no relationships that are not available for public inspection.

VICE CHAIR TRIVETTE indicated that he saw no objection from board members to Mr. Bader's described course of action.

Changes to Internal REIT Program: The internal real estate investment trust (REIT) portfolio has underperformed the NAREIT Equity Index since the program's inception about three years ago. Staff still believes in the value approach they use, but one reason the portfolio has not faired well is because it is limited in the types of REITs to invest in: there are no hotels, timber, or other specialty types of REITs. Staff proposes a new approach that allows investments in all asset types included in the NAREIT Equity Index so that the portfolio becomes more index-like.

Rob Johnson, the board's legal counsel, recommended that the board take official action on staff's proposal to amend the internal REIT program.

MS. HARBO moved that the Alaska Retirement Management Board approve the changes to the internal REIT program as laid out in the staff report. MR. RICHARDS seconded.

The motion passed without objection.

Eaton Vance Transfer: Transfer $5 million from Eaton Vance Emerging Markets Collective Trust to the Eaton Vance Structured Emerging Markets Fund. The Emerging Markets Collective Trust has prohibitions against having their investments made in health plans and other pension benefits. Moving the assets to the Structured Emerging Markets Fund would accommodate the State's change to setting up trusts to house all the investments *(presentation on trusts by the Department of Law later in the day)*.

Nomination by Money Management Letter: The newsletter nominated the Alaska Retirement Management Board for large public plan of the year. The decision will be made in March.

Barclays and Securities Lending: The ARMB has an S&P 500 account and two fixed income accounts with Barclays that participate in securities lending arrangements. There was discussion at the last board meeting about making plan participants aware that these are securities lending accounts. Staff followed up by discussing with Barclays the ARMB's wish not to be involved in securities lending activity. Mr. Johnson helped encourage Barclays to see things from the board's position, and staff has received a letter from Barclays indicating that they will be initiating non-securities-lending accounts in the asset classes offered to the defined contribution participants. [A related action item appears later in the agenda.] The goal is that by the next quarter the participants will be mapped to those new accounts.

Blum Investment: At a recent meeting the board granted permission to terminate the relationship with Blum. There is a public market component and a commingled fund component. The ARMB is out of the Stinson (public market) account, but the closed-end commingled account will take a long time to exit.

Senate Finance Committee Appearance: Mr. Burnett, Mr. O'Leary and Mr. Bader appeared before the Senate Finance Committee on February 10 and 11 where the dialogue included the ARMB investment process. It appeared that the information was well received.

5. Treasury Division Report

Deputy Commissioner JERRY BURNETT reported on proposed legislation to prohibit certain investments with companies that do business in Sudan. He and the commissioner support the version that is written so the implementation would have no significant negative consequences to ARMB investments or have any incremental costs.

COMMISSIONER GALVIN said the Governor and the Administration support this bill, which would impact ARMB, the Alaska Permanent Fund Corporation, and various funds for which the Department of Revenue commissioner acts as fiduciary.

6. Brandes Investment Partners

GLENN CARLSON, Chief Executive Officer of Brandes Investment Partners, and JUAN BENITO, Portfolio Manager, reported on the international equity product the firm manages in a separate account for defined benefit assets and in a mutual fund type account for defined contribution plan participants. *[A copy of the Brandes presentation material is on file at the ARMB offices.]*

MR. BENITO said the defined benefits account totaled $612 million at December 31, 2008, and the defined contribution plan participants had about $130 million invested. Brandes manages both international equity account types exactly the same way. He said that, given the market environment, their presentation would focus on the fundamentals. The calendar year performance for 2008 was negative, compared to Brandes' report to the board last year when they were outperforming the MSCI EAFE Index over the long term. Short-term underperformance is a necessary evil, even for those who outperform over the long term. Despite all the horrible economic environment reported in the press, markets are still up over the last five years. It is important for investors to focus on the inputs, such as whether Brandes has changed or is still applying the same discipline.

MR. CARLSON reported that as of December 31, 2008, Brandes was over $52 billion in assets under management — down by more than half what it was 1-1/2 years ago. However, the organization is in good shape. Brandes had closed most of their products for new investors in the early 2000s, and, in fact, international equity was closed in 1998. Through the ramp-up of the bull market over the last ten years Brandes did not have an overwhelming growth in personnel. The firm is a privately run partnership, has no debt, and did not acquire anybody else. So even though they have seen a substantial decline in revenues, Brandes is still a profitable organization. The 2008 bonuses to the entire staff were flat relative to 2007, while bonuses in the industry were reportedly down 20-50%. Brandes has no plans for head-count reductions in 2009. They are running the partnership as an asset management firm with a long-term view - retaining high quality people, and they believe that clients who left will come back to the firm. Brandes did not lose any institutional clients in international equity products in 2008, and in global they lost two or three small institutional clients. The bulk of their assets are managed in international and global, and most of that is for institutional clients.

MR. CARLSON stated that nobody is pleased with the investment results that Brandes has offered, despite the international equity doing better than the MSCI EAFE Index in 2008. Everyone at Brandes is working together, and they expect no personnel losses, so the inputs to their process are healthy.

MR. CARLSON said he has been in the investment business for 25 years, almost 23 of those years with Brandes, and he has never experienced anything like this. Charles Brandes, who has been in the business for over 40 years, says the downturn is as big as he has ever seen it. There was real pessimism in the markets in 1973-74 and valuations were very low. Mr. Brandes opened up his management firm in 1974, at the bottom of the bear market, because what better time to build a track record going forward. It was a difficult time, and the results subsequent to that have been very positive for investors broadly. The question is whether it is different this time than in 1973-74 and if the markets are in for a protracted period of very poor returns. Brandes does not have the answer to that question. He personally does not see data that indicates the world is in a depression or that there will be ten years of 20-25% global unemployment. He travels the world, and the world is still functioning. That is not to suggest that things will not be difficult, but he is not working in the context of global depression. With that viewpoint, this is the best opportunity in his career because the valuations are so compelling in so many areas. If one believes in the concept of global depression, financial assets (equities, debt, etc.) are not an excellent place to be broadly. But outside of that, from Brandes' perspective, it is as good as they have seen. Brandes believes — and history has shown over long periods of time — that prices can be good predictors of performance, so capturing low valuations gives the probability for a good result in the future. The "when" is unknown, but it feels like it would be a terrible time to meaningfully reduce allocations to equities. The data that Brandes looks at says at least stay the course because the valuations are very compelling.

MR. BENITO reviewed the sector exposure of the ARMB international equity portfolio. He said they make the decisions for the portfolio stock by stock, buying those with the largest discount. Brandes has a very large underweight in the typical traditional value sectors - those with high fixed costs and that are cyclical - because those sectors were at their peak. The portfolio has little or nothing in energy, materials, industrials, and utilities. Things are starting to change now and by next report Brandes will likely have a weighting in energy. Stocks there have come from being overpriced to being under priced. The weightings of the portfolio changed very little in 2008, but there can be major changes going forward if the stocks Brandes is looking at in the cyclical sectors present discounts that are larger than other opportunities out there.

MR. BENITO stated that there are over 60 industries in the world, but the portfolio is invested in only 22 of those. Of those, almost 50% of the portfolio is invested in three industries: diversified telecom services, commercial banks, and pharmaceuticals. Two of those industries have done quite well compared to the rest of the market - pharmaceuticals and diversified telecom services. The portfolio has no exposure to oil and gas or metals and mining: at different periods that has helped, but over the full year it has been neutral to be out of those.

MR. CARLSON said the portfolio has an overweight in Japan that has helped as the yen has gone up. What makes them excited at Brandes is that the number of opportunities and the size of the opportunities is growing. The ARMB portfolio is well positioned for the future, and the time is right to be in value stocks.

VICE CHAIR TRIVETTE said he appreciated Mr. Carlson's update on Brandes as a company because it answered several questions he had about personnel. He asked if Brandes anticipated changing the industry exposure of the portfolio significantly over the next year. MR. CARLSON said he did not know for sure, but Brandes is doing a lot of work in commodities, oil and gas, industrials, etc. Where they have a zero weight there currently, he would not be surprised to have some names start showing up that they have not had for years — but the stock selection is all done bottom up. The money for that would likely come from sectors where the portfolio is significantly overweight.

MR. O'LEARY noted that Brandes has Royal Bank of Scotland - one of the "walking dead" - in the portfolio and asked for comment. MR. CARLSON replied that Brandes has been an investor in financials forever, which is a common place for value investors. They stress tested the bank businesses by putting into the valuation model historically high loan loss reserves and that the banks would have to raise a lot of capital. Brandes believed that Royal Bank of Scotland's valuation was substantially higher than the stock price and so they bought it. Brandes knew problems were coming but underestimated the size of loan losses occurring throughout the world. While RBS created pain in the portfolio, not all financials are the walking dead. They are looking at whether Royal Bank of Scotland should retain a place in the portfolio, but they are not pleased that they missed.

MR. O'LEARY asked how a large investment manager thinks about a sector where the influence and control of the government is clear and difficult to forecast. MR. CARLSON said it captures a lot of Brandes's investment committees' time, energy and discussion because it is difficult to understand and forecast and to develop best estimates of what can happen in the future. A value manager strongly believes that price is a strong determinant of future opportunities. It is hard for the investment committees to argue that financials broadly are deeply overvalued, and they believe there is still a place for financials in the portfolios. Brandes is frustrated by the losses, but they do not believe the world financial system is done. They think the upside for returns on equities are likely muted relative to the history, and they have built that into the models. Listening to the worst coming from the U.S. and U.K. governments, there is a desire for private capital to be involved.

MR. CARLSON thanked the ARMB for being a long-time client and asked the board to be patient. He assured the board that Brandes is working hard on the retirement fund's behalf, and they believe they can generate good results.

VICE CHAIR TRIVETTE called a scheduled break from 10:13 to 10:22 a.m.

7. Capital Markets Assumptions

MICHAEL O'LEARY of Callan Associates, Inc. presented his firm's capital market projections for 2009. *[A copy of his slide presentation containing charts, graphs and other details is on file at the ARMB offices.]* He began by saying that Callan did not see the systemic crisis coming. Around the time of the board's education conference in Seattle last fall there were extensive discussions about the consequences of something like the Lehman bankruptcy and what it would mean to the financial system. At that point, things became very clear that this time was really different than prior recessions.

MR. O'LEARY said today's objective was to set the stage for a subsequent meeting when staff will present specific recommendations for potential changes in the Alaska Retirement Management Board's investment policy. Callan tries to develop a longer-term outlook and make valuation estimates. The numbers will be the midpoint of a range and are not point forecasts — the whole range is very important. Callan uses the forecasts in a model, and while each of the forecasts has to be independently defensible, they have to work as part of a set of capital market projections. Small changes in any of the three key inputs (the expected return, the variability of that return - or risk, and the correlation of one asset class with another) can have a huge effect on the outcome. For example, between September 2008 and year end, almost any asset that involved risk was almost a perfect inverse correlation with Treasury instruments. So in times of stress correlations all go to one: over the long term, they tend not to be very highly correlated. Callan is looking for combinations of assets that over a period of time do not all march to exactly the same drum. They tend to use consensus economic opinions. They favor *Global Insight* because it produces good charts, but they also look at projections from major financial institutions, such as JP Morgan. Callan's written material also included another investment manager's set of projections as a frame of reference.

MR. O'LEARY presented a chart of returns for stocks, bonds, cash and inflation for 2003-2008 to illustrate how one year can change the perception of returns between stocks and bonds. The Russell 2000 Index had a compound annualized return of 13.63% for the five years 2003-2007, and the Lehman Aggregate had a return of 4.42% for bonds. It would look like an investor should just own stocks. Moving ahead one year to the period 2004-2008, the five-year return for stocks was negative almost two percent, and the Lehman Aggregate return was 4.65%. Now it looks like an investor just should have owned bonds. Changes in five-year returns are not that unusual, but it is very troubling that the 15-year results for stocks are weak (6.36%) and roughly on par with the 15-year return for fixed income (6.18%). In the ARMB's September 30, 2008 performance report, the very long-term growth for assets was about 8.04%, which is important because the discount rate is 8.25%. The long-term growth for assets will get lower still once the December numbers are finalized. The magnitude of the decline in financial assets, particularly stocks, is truly remarkable and the effects will not go away with a recovery market of a year or two. The effect will stick in the long-term numbers for many years, even if Callan's optimistic forecasts from here forward are accurate.

MR. O'LEARY reviewed a list of events that happened in the second half of 2008, saying that one can lose sight of the enormity of the things that transpired. The concerns about the financial viability of other principal players in the financial system resulted in tremendous risk aversion and people trying to scramble away from any potential source of risk. Since year end, the size of policy response around the world has been unparalleled. The best measure of that is the decline in short-term interest rates. Within days people in the real economy had to make radical changes to how they were doing business.

MR. O'LEARY showed a histogram of over 200 years of annual period stock market returns: 2008 was -37.0% on the S&P 500 Index, and there are very few calendar years as bad or worse than that. There have been other periods (not annual) where the stock market has fallen as much or more: the 1973-74 bear market that Brandes mentioned earlier that fell about 49% from top to bottom, and the dot-com bust from top to bottom was of comparable magnitude. This market decline is so unusual in that so much of it has been packed into a comparatively short span. MR. O'LEARY also explained a graph of rolling five-year geometric returns for the S&P 500 for 1926-2008. The average return of all the five-year periods is 10.35%. Looking at how good or how bad a five-year period could be for stocks, a bad five-year period would be zero return, a typical would be somewhere near 10%, and a very good five-year period would be in the high teens. That covers a broad range of economic conditions — depressions, wars, significant inflation, assassinations, and stagflation.

GEORGE WILSON asked if the data would look much different on a rolling ten-year basis. MR. O'LEARY replied that the longer the period, the less extreme the variations. Right now, the ten-year data looks pretty terrible in an historic context because it is so unusual to have two major bear markets within a ten-year span. The ten years capture the dot-com bust but not the bubble, and it captures the current bear market.

MR. O'LEARY proceeded to describe the spread of investment grade bonds over Treasury instruments being at historic highs. The less secure someone is that they will get the money back that they loaned to a borrower, the greater the compensation they will require to lend that money. So there is equity risk in lending to almost anybody, other than to governments that have the ability to just print money. Some would point out that the governments that are part of the European Union do not have the flexibility to individually print money. The spreads on investment grade bonds relative to Treasuries have narrowed since the end of 2008. Spreads can narrow two basic ways: Treasury yields can go up, or credit yields can come down — and there are infinite combinations of the two. In the fourth quarter of 2008 the Treasury yield went through the floor because that was the only asset that people wanted to own. Treasury inflation protected securities (TIPS) were selling at a yield that implied that there would be zero inflation for ten years. Between 1979 and now there have been several periods of spread widening, but we have never seen anything like 2008. High yield bonds were yielding close to 20% in the fourth quarter of last year. Even with a 10% default rate estimate, and presuming a recovery of 30 cents on the dollar on the bonds that default, a high yield investor could still expect a total return in the double digit range. The high yield default rate is going up from where it is, but right now it is still comparatively low.

MR. O'LEARY explained the consequences of what has happened:

1. The financial system will be structurally different. Investment banks like Morgan Stanley and Goldman Sachs have converted into regulated commercial banks. They cannot be as leveraged as they were under the old model. There will be less leverage available in the economy for the foreseeable future, and leverage had fueled rapid growth in the last decade or so. The country cannot expect rapid economic growth on a long-term basis without that use of leverage.
2. The U.S. government's borrowing needs will expand significantly over the next three or four years.
3. The U.S. consumer has lost a lot of money in housing equity and financial assets. As housing prices continue to decline, more and more people are affected, even those who made a good-sized down payment and borrowed responsibly. The prevalence of people participating in defined benefit plans has changed, and many people relying on a contribution plan when they retire are going to be affected by this loss of financial assets. Further, as many as 25% of employers, particularly in the private sector, have taken an employer contribution "holiday" in their defined contribution plans and are not making matching contributions.

MR. O'LEARY stated that the current recession officially began December 31, 2007, but that date could be revised in the future because there was real GDP (gross domestic product) growth in the first two quarters of 2008. The projection for 2009 is a significant decline for real GDP. Looking at the current economic environment, people have reason to believe that this recession will be really bad. The important question is, how bad will it be? Callan's best thinking when building its forecast is that a recovery will have begun by the end of 2009. It will not be seen in things like an improved unemployment rate until 2010, because the unemployment rate tends to be a lagging indicator.

MR. O'LEARY explained Callan's outlook that there is so much slack in the economy that inflation will not be an issue well into 2010, and that low interest rates will persist. They do not see a pickup in demand that will create the price pressures in commodities. However, Callan is very concerned about inflation longer term. Looking back at other recessions, stocks start doing better before a recession ends. Because of the September-December 2008 credit market freezing, there is still a lot of financial risk in the market. One example of that risk is commercial real estate, where loans tend to be balloon instruments that require principal repayment at maturity. The commercial real estate loan rates several years ago were 5%-7%, but today the rate to refinance the debt on a property is much higher — if the borrower can even obtain the financing. That risk does not pertain only to commercial mortgages. For below-investment-grade companies that have traditionally gotten external financing needs via the bank loan market, the cost and access to that money is very different than it was twelve months ago. That difference in capital costs may be great enough to push a lot of folks over the edge. The other unfortunate consequence of that will be further unemployment.

MR. O'LEARY said Callan's outlook is that equities will be more reasonably priced, based on price/earnings ratio and price/book value compared to the long-run averages. He reminded the board that even through the dot-com bust corporations were improving their financial position, and earnings subsequent to dot-com were very good. From a valuation perspective the companies clearly are worth more than they were then, and since the stock prices are lower than they were then, presumably they are more undervalued. In the post World War II period, stock market returns during recessions were positive 1.4%, on balance. This means that stocks begin to recover before a recession ends.

MR. BADER asked what the data said about rebalancing portfolios, even when the economic news is dark. MR. O'LEARY said that ideally when the board formulates an investment policy they recognize that there will be periods when things look ugly. The reason the retirement fund portfolio is diversified is so that when one part of the portfolio gets ugly, some other part of the portfolio is over allocated, and the board moves back to its policy. It is unproductive to wait until everybody says "it is time."

MR. SHIER said the board heard today that leverage is absent in terms of being available for economic recovery, and that is expected to extend the length of the recovery. Also, the U.S. economy has been moving away from creating new wealth through producing goods and more into a government and service economy. He asked how that impacts the expectation for a recovery.

MR. O'LEARY stated that the economy is always changing, and big companies over time will change. Examples are how important big mainframe computers were to the economy; how the 100-plus auto companies became three and how important they were to the economy; and the impact of how railroads and airlines have changed. Globalization has accelerated the loss of what were traditional high-paying jobs: the blue-collar, unionized manufacturing jobs of the 1950s and 1960s were very important contributors to the growth of the economy. Those people purchased houses with mortgages and bought cars on time, and it was a good economic environment in part because of that. The good thing probably got extreme, and now some of the auto companies are encouraging workers to leave so that they can replace them with workers who are earning literally half of what current employees are. That reflects the need to change the cost structure in order to be competitive with companies that are not laden with a history of benefit programs. On the other hand, Google, although not having a great year, is still hiring people at a time when advertising is way down. There has been a big increase in health-related companies. So the economy has a great ability to change. He believes the absence of leverage will slow the secular growth rate. In many respects, the U.S. is in a better position with regard to expected growth in the labor force. And some would argue that all this turmoil will force people to defer retirements, so that would be an unexpected boom.

VICE CHAIR TRIVETTE inquired about the impact of the accounting mark-to-market rule to require recording the value of a security or portfolio at its current market value. MR. O'LEARY said it has already had a huge impact for banks but not so much for pension funds, although there will be some impact there. There was a huge banking crisis in the early 1990s, and if there had been mark-to-market requirements then all the major banks would have probably gone bankrupt. The fundamental issue today is that banks are saying they have adequately marked down the impaired assets on the balance sheet, but if the banks had to sell the impaired assets tomorrow we would find out that they had not. Mark-to-market will be a real factor in private equity, where for a long time the volatility that was inherent in the underlying assets was not apparent. Callan has used a 16.5% volatility estimate for real estate for many years, while the observed volatility has been less than 4%. Their position is that some assets are like equity and to assign equity like volatility to them.

MR. O'LEARY next reviewed bond yields. He said Treasuries currently have very, very low yields, and the correlation between Treasuries and credit instruments has been almost inverse recently. The yield to worst on the Lehman Aggregate Index at the end of 2008 was 3.99%. In years past, Callan has stated that yield-to-worst is the starting point for them building a five-year projection. Does this mean their Aggregate projection is 3.99%? No, but Callan had to exercise their minds to figure out why that would not be the case. The duration for the bond market index has also changed. Typically around 4.5 years, the duration fell to under 3.8 years by the end of 2008. The expectation is that mortgage refinancing will increase tremendously, but that option is not available to everybody because some homeowners have no equity in their homes.

MR. O'LEARY stated that the government will be issuing so much additional debt that on average Treasury yields will be higher. And credit yields are too high relative to Treasuries, so spreads will narrow. Between those two factors, Callan rationalizes keeping the bond estimate at 5.25% for the Lehman Aggregate, the same as last year.

Moving on to the table of Callan's 2009 capital market projections (slide 26), MR. O'LEARY said they changed it this year to include the arithmetic returns to accommodate clients who wished to do ten-year modeling or three-year modeling. The arithmetic return is a one-year projection. The more volatile an asset class, the greater the difference between the compound annual return and the arithmetic return. For example, venture capital has a projected arithmetic return of 17.25% and a projected compound return of 11.56% because the volatility is so high.

The geometric mean returns for the major risk asset categories have been increased because the starting point is so much lower: Callan cannot ignore a 37% decline in equity values in 2008. There are no appreciable changes between large and small capitalization equities, or domestic and international equities. MR. O'LEARY said that he personally believes that 2009-2010 will be a wonderful time to buy real estate, but the return numbers will not show it because the numbers have such a lag in them. The NCREIF Index posted a meaningful decline in appreciation during the fourth quarter of 2008, and people who own commercial real estate are likely to experience a further decline in apparent value in the first half of 2009. So Callan's projections want to take that into account.

MR. O'LEARY said the same sort of thing has been happening with private equity. Some of the private equity funds that were involved in the mega buyouts had significant refinancing risk embedded in their investments. The companies that they bought are not doing great, but they are still big companies. But the ability to service the debt that they put in place is a critical issue. The best case is that private equity funds get the debt refinanced but at a much higher interest rate than they had expected, so the profitability of that investment likely will be less than what they thought. The third quarter saw some write downs in private equity, and he expects it to be much more significant in the fourth quarter. With all the smaller companies that currently do not have access to financing, there are great opportunities for a private equity investor with money.

MR. BADER remarked that Callan has to make some heroic assumptions to put together its capital market projections. He recalled that Callan has analyzed how accurate their projections were in the past, and he asked for further comment.

MR. O'LEARY stated that every year Callan combines their five-year projections at a portfolio level to see what the actual result was relative to the range of returns that were embedded in the forecasts at the time they were made. The projections are always wrong, but they tend to almost always fit within the bands that were projected. Even the forecasts Callan made before dot-com took off looked very low, and the forecasts that were made in 2000 when the bubble was bursting looked too high, but they ended up being well within the bands. Unless a miracle happens, the forecasts for last year and the year before on equity related asset classes will be wrong and run the risk of being outside the bands because the market action was so extreme in 2008.

DR. JENNINGS said that a natural reaction would be to have bigger risk assumptions going forward, in light of extreme market results, and yet Callan and other consulting firms are not changing their risk assumptions. He asked if investors should think there is more risk in the tail end.

MR. O'LEARY replied that it is a popular issue. He said the biggest area of failure on the part of professionals thinking that they were looking at risk was to not recognize that at some point the severity of the risk is massive. Strategies and approaches that looked very reasonable 95% of the time only take a 1% event to undo everything else. The risk tools that banks used to judge their own exposure, and the risk tools that hedge funds may have used in determining the wisdom of a particularly levered strategy, were generally found to be wanting. He did not think that simply pushing out the standard deviation would be useful for that, in fact, it might instill a greater sense of tranquility than is justified. What is actually needed is a non-normal distribution forecast. People are not worried about the good tail, they are worried about the fat bad tail. The problem is how to assign the probability of occurrence to that, and how to define how bad is bad. Callan has not found a better tool to do that, but they take into consideration the spreads between risky assets and less-risky assets so that it is harder for the optimizer to take on the greater risk. They do that so people are not encouraged to put the pedal to the metal.

MR. O'LEARY stated that Callan has not finished all the assumptions needed to deal with the ARMB's particular program, which, for example, includes real assets. Based on crude approximations, he guessed that the ARMB policy that last year produced an expected return of 8.12% would produce about 9.09% this year.

LUNCH RECESS

VICE CHAIR TRIVETTE recessed the meeting at 11:50 a.m. for a lunch break. When he called the meeting back to order at 1:10 p.m. trustees Schubert, Trivette, Harbo, Galvin, Erchinger, Williams, and Richards were present. Commissioner Kreitzer rejoined the meeting at 2:04 p.m.

REPORTS (Continued)

8. Executive Session: Litigation Matters

MS. HARBO moved that the Alaska Retirement Management Board go into executive session to consider information the immediate disclosure of which may have a financial impact on the system and to receive attorney-client privileged information. MS. ERCHINGER seconded.

The motion passed unanimously on a roll call vote, and the board met in executive session starting at 1:11 p.m. When the Chair reconvened the regular meeting at 1:42 p.m. he reported that no business was transacted during executive session.

9. Senator Stedman Addressed Board

SENATOR BERT STEDMAN (Sitka) reported that before the legislative session started he had some conversations with the Administration about encouraging an additional contribution into the retirement system unfunded liability this year, and to keep doing that even in tough financial times. The amount in the budget is about $400 million, but that is under review and could be adjusted in the context of broader funding issues. He encouraged the board, when they are considering the 1-1/2 to two-year lag in the actuarial valuation data, to weigh what has been happening in the financial markets in their decision on setting the employer contribution rates so that the rates do not decline and then maybe go up substantially in a year or so. That creates false expectations that things are actually different from what they are. The Legislature will be looking at the actuarial report when it comes out and then will sit with the Administration to look at some additional contributions next winter or in the next budget cycle. There is information circulating that the liabilities are declining to a point where the situation will be behind us, but he does not agree with that.

Responding to VICE CHAIR TRIVETTE, SENATOR STEDMAN stated that an additional contribution toward the unfunded liability is on the table but it will probably change because there is a budget deficit issue, depending on what the updated revenue numbers are coming out next week.

VICE CHAIR TRIVETTE stated that the ARMB has been supportive of additional state funding toward the unfunded liability in the past and would probably support the Legislature doing it again. He thanked Senator Stedman for his support in working with the Administration on that.

10. Fund Financial Report

PAMELA GREEN, State Comptroller in the Treasury Division - DOR, and KEVIN WORLEY, Chief Financial Officer in the Division of Retirement and Benefits - DOA, presented the ARMB financial report as of December 31, 2008.

MS. GREEN said the total invested retirement assets at 12/31/08 were $15.1 billion, a decline of close to $3.4 billion from the 06/30/08 invested assets total, or a difference of almost 17.6%. She listed the funds individually, as follows:

- PERS System was down 19%
- TRS System fell 17.5%
- Judicial Retirement System lost 20.6%
- Military System declined 7.1%
- SBS Plan lost 12.3%
- Deferred Compensation Plan was down 13.2%

MR. WORLEY reviewed the two-page supplemental information that provided the net contributions and withdrawals by system for the six months ended 12/31/08:

- The PERS System (defined benefit plan and defined contribution plan) had an increase of $61 million: total contributions from employers and employees plus the State of Alaska contribution of $540 million versus expenditures for benefit payments, refunds and administrative costs of $379 million. There was also a transfer out of the PERS Health Trust back to the TRS Health Trust (creation of the Alaska Retiree Health Care Trusts for the three retirement systems was discussed at the September meeting).
- The TRS System had $277 million of income to the plan versus withdrawals of $217 million, plus the $65 million transfer from the PERS Retiree Health Trust to the TRS Retiree Health Care Trust, for a net contribution to the system of $125 million.
- The Judicial Retirement System had $3.8 million of income, all of it employee and employer contributions, versus benefit payments and administrative costs of $4.1

million, for a net draw-down of $236,000.

- The Military Retirement System only has employer contributions, which were $2.5 million, and benefit payments and administrative costs of $825,000, for a net increase of $1.6 million.
- The SBS Plan had employee and employer contributions of $68 million versus refunds, transfers, rollovers, and administrative costs of $68 million, for a net increase of $202,000.
- The Deferred Compensation Plan had employee contributions and transfers in from other plans of $18.3 million versus refunds and administrative costs of $13.8 million, for a net increase of $4.5 million.

MS. GREEN stated that there was net investment income of $258 million for the month of December. The preliminary January 31, 2009 number for the defined benefit plans show a decline of about 4% since December. The final reports should be out by month end.

MS. GREEN reviewed the total invested assets, investment income, actual asset allocation versus the target allocation, and the major asset classes for each of the retirement funds. She pointed out the inclusion of new summary charts for the Retiree Health Care Trust Funds for PERS, TRS, and the Judicial System. She also noted that the actual asset allocation for fixed income in the Judicial Fund was on the high side because the plan had zero investments in private equity at this point.

MS. GREEN briefly reviewed the defined benefit retirement plans by the dollars invested in each asset type for the month ended 12/31/08. The same information for the participant directed plans was included in the written report.

11. T. Rowe Price Review of Portfolios

MR. BADER stated that T. Rowe Price runs several mandates for the SBS Plan, the Deferred Compensation Plan, and the Defined Contribution Retirement Plans. He said that T. Rowe Price uses building blocks to assemble the various portfolios they run in the Alaska Target Date Funds and the two Alaska Balanced Trusts. He introduced portfolio managers NED NOTZON and CHARLES SHRIVER, and client services director BOB BIRCH, who were present in Juneau. TONY LUNA joined later in the presentation by telephone. *[T. Rowe Price was allotted 70 minutes on the agenda for their presentation. Details not provided in these summary minutes are contained in a presentation booklet on file at the ARMB offices.]*

MR. BIRCH thanked the board for the opportunity to extend T. Rowe Price's assignment for Alaska with the addition of four new target date funds and by opening the existing investment offerings to the other retirement plans. He stated that the T. Rowe Price firm has remained stable and financially healthy throughout a tumultuous market environment. They are supported by a conservatively managed balance sheet with more than a billion dollars in cash and securities and no debt. There have been no changes in the firm's management team, or in the portfolio managers participating in the Alaska portfolios, and no staff reductions. Similar to the market dislocation in 2001-2002, T. Rowe Price is finding this an extraordinary period to continue investing in key investment areas.

MR. SHRIVER briefly reviewed a timeline of the relationship with the Alaska retirement system since it began in 1992, highlighting the improvements in investment offerings along the way. He also displayed the current array of investment options: Alaska Balanced Trust, Long-Term Balanced Trust, Target Date Trusts 2025, 2020, 2015, and 2010, Small Cap Stock Trust, Stable Value Fund, Money Market Master Trust, and Interest Income Fund. He described the building blocks that allow T. Rowe Price to provide a customized suite of asset allocation funds for State of Alaska participants at an attractive fee: Money Market Trust, Aggregate Trust, U.S. Equity Trust, and International Trust. He then explained the latest round of improvements that will be implemented in April 2009. One important change is expanding the Target Date Retirement Trusts to range from 2010 through 2040, at five-year increments. These are offered as common trusts, which facilitates their being provided across a greater range of plans. Another major change is the new glide path for the Target Retirement portfolios, which is designed for both pre- and post-retirement. It starts at 90% equities and gradually becomes more conservative as retirement approaches and then into and through retirement. The new glide path is designed to recognize the longer lifespan of participants so they can live and take assets from the plan over a 30-year or greater retirement horizon.

MR. BADER asked T. Rowe Price to explain the assumptions that participants might draw from the fund after retirement and the probability of them not having enough money after age 90. MR. NOTZON stated that the driving factor in designing the Target Date funds was that people not run out of money before they died. Longevity has been increasing: currently, if a participant and spouse both retired at age 65, there is a 52% likelihood, according to the Society of Actuaries, that at least one of them will live to be age 90. Many financial planners are still using a 20-year time horizon from retirement, to age 85. T. Rowe Price is using a 30-year time horizon. The goal is to have a set of portfolios where the likelihood is at least 90% that the assets will last 30 years. Most of the time, a participant will have positive assets at age 95. The assumption is that a participant will withdraw 4% of their money annually, and that they will increase that withdrawal by 3% each year to compensate for cost-of-living increases. Many people withdraw 6%, 8% or even 10% a year, even though it is not sound financial planning, in which case they will not hit the 30-year target but they will still do better than if they were using a different glide path. T. Rowe Price found that the sweet spot in the calculations was to draw the assets down to about 55% equity at age 65 and then to continue drawing it down until equity is 20% of the portfolio by age 95. The actuarial tables indicate that 6% of the people will live to be 100, and projections for five years from now suggest that people will live even longer.

MR. NOTZON stated that Alaska's were the first target date funds that T. Rowe Price brought out (1996). The firm introduced its own target date mutual funds in 2003. By that time, they had done a huge amount of analysis on the Alaska target date funds and they continue to study them. Two thousand and eight was a truly exceptional year for the stock market and not typical at all. T. Rowe Price did Monte Carlo analysis including 2008 and they found that if a participant retired right when the market hit its worst (and with 55% equities in their portfolio), for that subset of cases the likelihood of their assets lasting 30 years is less than 90%. But all the cases with less than 55% equity exposure do even worse. Of interest is that about three years ago two main competitors that had dramatically less equity exposure in their target date funds more or less adopted T. Rowe Price's glide path. T. Rowe Price believes that one should not design a portfolio for the worst year: it is the accumulation of assets for 40 years from age 25 until 65, and it's the 30-plus years after retirement from 65 to 95 that dominate what will happen to the portfolio.

MR. BADER related that the U.S. Department of Labor states that if boards put target date funds in place they have a duty to re-evaluate the glide paths from time to time. He sought confirmation that the ARMB separate account structure with the building blocks in place lends itself to adjusting the glide path without adverse impact on the funds. MR. NOTZON said yes. He offered to come back and give a separate presentation on that and related questions to either the ARM board or the staff. Target date funds are becoming a dominant factor in defined contribution plans, and it is important that the funds work as well as they can.

MR. O'LEARY commented that the data does not show any meaningful running away from target date funds by participants, in light of this terrible market period. In fact, target date funds may have grown even more popular. But participant behavior and shock at how poorly the heavily equity laden target date funds have done in absolute terms could undo all the great planning in the world if participants vote with their feet and shift to the stable value fund.

MR. NOTZON conceded that it is a serious concern. For 2008 and January 2009, T. Rowe Price had positive net cash flows except for a two-week period in late September and early October, which was a disastrous time for the equity markets. T. Rowe Price has found that participants are much more likely to make a change if they own five or six funds and have accepted the responsibility for overseeing their own investments. Once participants put their money in a balanced fund or a target date fund they seem to feel that someone is looking after it. It is still their problem because they live with the results, but they seem very comfortable that professional managers are making the investment decisions. No one can say there won't be another 2008 in the next 70 years or even next 50 years, so T. Rowe Price continues to re-examine the possible outcomes. What started all this mess was the subprime mortgage debt, and those problems did not arise until mid-2007. T. Rowe Price got out of subprime mortgages in 2006 based on their analysis of that market, saving the portfolios a lot of grief.

MR. O'LEARY asked if collapsing the large and small cap equity funds into a single fund

(U.S. Equity Trust) would mean losing the flexibility to try and add value, or if T. Rowe Price could choose to emphasis a subasset class within the U.S. Equity Trust. MR. NOTZON responded that they are trying to match the market weights of the underlying securities. They used to have two benchmarks for the two equity funds — the S&P 500 Index and the Russell 2000 Index — but the U.S. Equity Trust has a comprehensive benchmark, the Russell 3000 Index. The principal mechanism for adding value is that they do not have to withdraw a stock from the portfolio the day it leaves the Russell 3000. Or they can add a stock early if they think it is attractively priced and there will be a pop when it enters the index. The tracking error to the Russell 3000 Index would be plus or minus 200 basis points most of the time. The U.S. Equity Trust is not a completely indexed fund and is driven by the new ARMB guidelines where T. Rowe Price is expected to not dramatically overweight or underweight a particular sector or stock.

MR. SHRIVER stated that even though T. Rowe Price consolidated to four underlying building block funds, they have the same breadth of diversification that the prior building blocks had. He noted that the Alaska Target 2010 Fund in the SBS Plan will be allowed to continue along its prescribed glide path, which matures at the end of 2010 at 100% cash. The Alaska Target 2015, 2020, and 2025 Funds will gradually transition from the glide paths they are currently on to the new glide path. The funds will be increasing the neutral weight to non-U.S. equities in order to recognize the increased globalization within the equity markets. T. Rowe Price has been working with Ryan Bigelow on a series of communications to the plan participants, as well as coordinating with Great-West to develop the investment option detail sheets for the new funds available April 1 to participants.

MR. NOTZON reviewed details of the current Target Date Funds, as well as the Alaska Balanced Trust and the Alaska Long-Term Balanced Trust. He noted that the Alaska Balanced Trust is the workhorse of the SBS Plan, holding 49% of the total assets there, and it represents 39% of all the Alaska assets under T. Rowe Price management. Roughly 10% of the participants have chosen the Long-Term Balanced Trust, which was introduced in 1996 with 60% equities and 40% bonds. When one considers that the SBS Plan is a Social Security replacement and an important part of people's retirement plans, it makes sense to err on the conservative side. The Balanced Trust had a -12.44% return in 2008, while the Long-Term Balanced Trust was -23.19%. All the Target Date Funds were negative for the year, and only the Money Market Master Trust was positive at 2.9%. It is a different picture looking at results since 1996, where the Balanced Trust returned 5.74% annualized. All the portfolios, with the exception of the Target 2025 Trust, have positive returns over that 12-year period. So despite 2008 being a horrendous year, the participants in general have made money rather than lost it. Diversification has helped a lot, and people have picked the type of risk they are comfortable with.

T. Rowe Price overweighted equities in the Balanced Trusts in the year leading up to March 2003 because the stock market had fared very poorly after the dot-com collapse, and they saw a lot of companies individually doing quite well. The market took off dramatically and equities significantly outperformed bonds until December 31, 2007 — and T. Rowe Price captured a handsome premium for that. They reduced the 3.5% overweighting in equities to a 1.0%-1.5% overweighting in the funds by January 2008. January caught them short of having gone all the way back to a neutral weight in equities, and that cost them 66 basis points of return in the Balanced Trust and 38 basis points in the Long Term Balanced Trust. But the funds probably gained a lot more than that in the preceding years because of the overweight to equities. T. Rowe Price did not foresee a lot of trouble in the domestic equities the way they did on the fixed income side when they got completely out of subprime mortgages. The Target Date Funds were sufficiently small that T. Rowe Price did not overweight equities because they were afraid they might unintentionally be someplace other than neutral when something happened. So the Target Date Funds did not get the premium from equities from 2003 on, but similarly they did not take a hit in 2008. T. Rowe Price's strategy is not to figure out how to get a good return next year but to find good stocks and good bonds, and the market will take care of it. They have been steadily rebalancing the portfolios as the equity market has declined, and that has cost them as stocks continue to decline. But it is important to rebalance lest they lose a lot more on the rebound when equity markets recover.

T. Rowe Price portfolio manager for the two stable value portfolios, TONY LUNA, joined the meeting by teleconference. He reviewed the performance for the Stable Value Fund offered in the SBS Plan in 1994 and the Interest Income Fund made available to Deferred Compensation Plan participants in 2004. Performance has been very good for the two separate accounts: the returns differ for the two plans because of cash flow volatility that equates to a larger allocation to the cash reserves for participant transactions. The Stable Value Fund in the SBS Plan grew by 50% in calendar year 2008, which is very strong growth. T. Rowe Price believes hoarding more cash in that fund seems more appropriate, not knowing how sticky that money is going to be and not knowing how liquid the fixed income markets will be. The Interest Income Fund in the Deferred Compensation Plan also grew in 2008 but only by 13%. The Stable Value Fund has been reinvesting money at lower rates, and adding that fact to the cash drag on the portfolio explains the return difference between the two funds.

MR. LUNA stated that a hot topic in the stable value industry is the market value of the assets versus the book value of participant balances. Total returns or even book value returns do not tell the whole story about the health of a fund. That ratio as of 12/31/08 was about 1.01 or 1.02. As of February 11, it was still around the 1.02 level.

MR. O'LEARY said this is an important topic that board members should understand. Many commingled stable value vehicles as of year end had a market value of the underlying assets of 93 or 94 cents on the dollar to the book value. MR. LUNA confirmed that the median market to book ratio for the Hueler Pooled Fund Universe was about 93 cents as of year end. So a 1.02 ratio is probably one of the highest market to book ratios in the industry and a good thing for the State of Alaska.

MR. O'LEARY explained that if a participant in a stable value vehicle that had 93-cents-to-a-dollar market value elected to transfer out to some other option they would get that dollar. He asked what happens to the missing seven cents in the example. MR. LUNA replied that the remaining seven cents on each dollar would be amortized out over the life of the fund, and the remaining participants would bear the cost of it. That gets translated into the crediting rates, which gets reset quarterly. The crediting rate on the fund would become incrementally lower. Lately, T. Rowe Price has been resetting the crediting rates monthly to keep market and book values as close as they can.

MR. O'LEARY said that if a plan sponsor wanted out of a stable value commingled fund, it would take a lot of time or they would have to take a loss in the value of the assets transferred out. MR. LUNA said that most commingled vehicles have a 12-month put provision for these events, unless there is excess liquidity in the fund and they can pay it out at book value. MR. O'LEARY said he raised this issue because the participants are reading about this and asking questions. MR. LUNA stated that in a separate account, such as Alaska's, if the state did something that the contract issuers deemed impacted the cash flows of the fund, the issuers have the right to terminate. But what happens is the contract unwind period is over the duration of the portfolio, or it becomes a market value event and the participants take a haircut on the payout.

MR. BADER requested comment on the benchmark change for the Stable Value Fund and the Interest Income Fund that the board made about a year ago and how that might have impacted the book to market value. MR. LUNA said that in 2008 they transitioned from two actively managed underlying strategies (one was benchmarked to the Lehman Aggregate Index and the other to the one to three Government Credit Index) to passively managed intermediate aggregate synthetic portfolios. The transition has been going well, and both portfolios are becoming more and more aligned with the index in sector allocation and credit quality. The primary difference between the two portfolios is that T. Rowe Price has more flexibility with the SBS Stable Value Fund because of larger contribution cash flows. They are taking their time and not necessarily liquidating good assets at distressed prices. The Treasury positions for both the Stable Value Fund and the Interest Income Fund both look a little light, but by contribution to duration they are actually a bit overweight in the Treasuries. While it is not a long track record, for the three months ended 12/31/08 the Interest Income Fund return was 3.95%, and the SBS Stable Value Fund returned 4.18%. The benchmark index was 3.58%. Most of that outperformance has been from the higher credit quality. T. Rowe Price thinks it is appropriate to be conservative and a bit more liquid, and they are being opportunistic in choosing which securities to sell.

MR. LUNA addressed the contract issuers, or the counterparties in the funds: State Street Bank & Trust Co.; Bank of America, N.A.; Natixis Financial Products, Inc.; Pacific Life Insurance Co.; and Rabobank Nederland. Even though there is no direct exposure to these counterparties right now because of the 1.02 market to book ratio, it is important to look at those five contract issuers. The financial industry in general is under downgrade pressure, and this won't be immune. T. Rowe Price is keeping a close watch on them and does not have any immediate credit concerns. Also, in the stable value industry there are capacity constraints with the counterparties, due to the capital at each of the financial institutions getting tight. Some of the wrap providers in the industry are actually shutting down deposits to their wrap contracts. T. Rowe Price is on pretty good footing currently, but many of their competitors have been shut out of the business. MR. LUNA said he could see T. Rowe Price holding more cash in the future anyway, but it is something to be aware of. There are rumors of people leaving the wrap business — UBS left last year, and of course AIG has its own problems. So there is a capacity overhang in the industry that everyone should be aware of.

MR. O'LEARY thanked Mr. Luna for addressing that issue and asked about the increase in wrap fees. MR. LUNA said for Alaska's plans it probably averaged seven basis points historically and is around 14-15 basis points now. The market rate is closer to 20. Also, contract provisions are becoming more restrictive, but it is not too much of an issue with Alaska's separate accounts because there isn't much active management, and most issuers are very comfortable with T. Rowe Price.

MR. O'LEARY mentioned that the wrap providers are not getting any money from the plans other than the fee they get paid to assure that there can be a book value payout. MR. LUNA said the contract issuers also provide a crediting rate which smoothes out the volatility of the underlying bond portfolios.

MR. BIRCH spent a few minutes reviewing the Small Cap Stock Trust that was offered as a stand-alone investment option in the SBS Plan and Deferred Compensation Plan in late 2001. It is broadly diversified in 280 stocks, representing both the small growth and small value segments of the market so that hopefully the portfolio would never underperform as a result of either growth or value being significantly in or out of favor. He said the investment approach has not changed, and the team managing the portfolio since 1992 remains intact. The Small Cap Stock Trust is an option where the board has been concerned about performance, but the picture is different more recently. The portfolio ended the year just marginally ahead of the Russell 2000 Index. The first quarter of 2008 was a particularly challenging period as the better performing stocks were narrowly concentrated in the energy and materials sectors, particularly agricultural fertilizers. While the portfolio had exposure there, they were quite concerned about how narrow the market had become, about stocks tied to a weak dollar, about growing inflation, and a sentiment they did not agree with that emerging markets had decoupled forever. The market started to change in July 2008, but it was not until the fourth quarter that the defensive positioning of the Small Cap Stock Trust took hold. This is a strategy that performs relatively well in sloppy markets but has a more difficult time keeping pace in the most speculative and aggressive markets. For the three years ended 12/31/08, the Small Cap Stock Trust produced essentially the same return as the Russell 2000 Index, with approximately 20% less volatility in returns.

VICE CHAIR TRIVETTE called a scheduled break from 3:13 p.m. until 3:26 p.m.

12. Actuarial Audit Report

MR. BADER introduced WILLIAM FORNIA and MARY BETH REDDING of Aon Consulting, Inc., the firm hired to conduct an actuarial audit of the state's primary actuary, Buck Consulting, Inc., a requirement contained in Alaska statute 37.10.220(a)(10).

[A copy of the Aon Consulting's detailed written report, dated January 30, 2009, as well as the slide presentation, were included in the meeting packet and are on file at the ARMB offices.]

MR. FORNIA stated that Aon focused on actuarial assumptions, actuarial methods, the experience study replication, and the actuarial valuation replication. The bottom line of the actuarial audit is that things look pretty good. Aon would have done some elements differently, but in terms of matching numbers the difference was only 0.17%. Aon does a lot of audits, and the rule of thumb for actuaries is a 5% tolerance in the numbers, so a 0.17% difference is a good sign.

MR. FORNIA said the economic assumptions used in the actuarial valuations were reasonable and consistent. The inflation rate of 3.5% is very consistent with what other public pension funds use. But the difference between the yield on Treasury Inflation Protected Securities (TIPS) and the non-inflation indexed bonds is only 1.0% right now, which is what the market is betting inflation is going to be. So there is a huge disparity between what actuaries are using as an inflation estimate and what the bond market is using. Callan's inflation assumption is 2.75%. The board should be aware that the actuary is being more conservative in the inflation rate than the underlying market.

MR. FORNIA said the ARMB investment return rate is 8.25%, which is higher than most retirement systems that are using 8.0% or less. But given the inflation assumption of 3.5%, that makes Alaska more in the middle in terms of a real return rate. Aon believes the payroll growth rate of 4% is reasonable, and the salary growth rate is also reasonable. Buck Consultants' experience study looked at total salary growth during a time when inflation was low, and they did not make that distinction. Gabriel Roeder Smith & Company, the second actuary hired to review Buck's work, also mentioned that in their report. Aon encourages Buck in their next experience study to calculate the salary growth rate on a net basis so they can reflect which of the experience was due to inflation and which of the experience was due to real salary growth.

MR. FORNIA said Aon checked all the demographic assumptions, and for the most part they are fine. The health care assumptions were reasonable and consistent. Buck starts with a base claims rate, which is the average claim cost for everybody and based on past experience. Buck then applies morbidity, or aging, factors because health care costs vary by age, and the method is more accurate than projecting costs as the group gets older. Aon liked the way Buck did that. Then the trend rate takes those claims and trends it forward with future medical inflation. Buck did a good job of that. Once the projections show what the total health care costs are, other important factors are who will participate and what the premiums are. Buck assumes that everybody takes the health care, which Aon believes is a little on the conservative side. Some people still have to pay for part of their health care, depending on when they retire.

MR. FORNIA next talked about the actuarial methods. The entry age normal cost method is the most common method that actuaries use to spread the cost from year to year. Alaska switched back to this method a few years ago, and Aon believes that is a great method. Asset smoothing method - Buck spreads the unanticipated investment income, more or less than the 8.25% investment rate, over five years. That is a common practice, and Aon checked the way that Buck does that.

MR. FORNIA stated that the Alaska retirement plan has an unfunded liability, and every year Buck tells the state what the cost to the plan is. There is the cost of ongoing benefits (the amount to pay this year, which is called the normal cost), and then the unfunded liability that has to be paid off. The way the plan pays off the unfunded liability is to use the same percentage of payroll year after year based on a 4% total payroll growth rate. Each time there is an addition or subtraction to the unfunded liability it will be spread over 25 years. So each year starts a new 25-year payoff, which is a pretty sound method. One problem is that 25 years is long as the closed defined benefit plan continues to be closed. The plan has only been closed two years, so maybe a 25-year amortization is not so bad, but ten years from now, if everybody in the plan is 35 years or older, 25 years is going to sound a little long. So the board might want to consider revisiting that 25 years and start phasing it out in a couple of years — 25, 24, 23, etc. or something along those lines — assuming the plan stays closed.

The other problem is that the Governmental Accounting Standards Board (GASB) does not allow use of the 4% increasing payroll method for the amount put on the books, but it does permit 30 years of amortization. Buck tests the 25-year amortization method under the GASB rules to make sure it complies with GASB also. Since the Alaska retirement plan has these new 25-year amortizations, on average the unfunded liability is probably funded over 22 years or something like that right now. So there is some cushion, and the method used is currently meeting the GASB requirements. With 2008 being a terrible year for investment returns that will be smoothed over five years, it is possible in three or four years that spreading the unfunded liability out over 25 years with the 4% increasing payroll method might cause a problem. Aon recommends that Buck monitor to see if they are going to get in trouble with this method.

MS. REDDING next explained Aon's replication of Buck's experience study for PERS, TRS, and the PERS Peace Officer/Firefighter systems. Aon found that their re-creation of Buck's study had a very good data match overall, but a few fields did not match quite as well. Experience study matching is very difficult and is not done very often. One issue with this one was that the data was coming from two different sources, it was not always consistent, and Aon had to make more assumptions than they might have expected to. But overall they liked the results they got.

MS. REDDING illustrated graphically where some differences occurred in PERS Peace Officer/Firefighter post retirement mortality numbers at the tail-end age groups. She cautioned that this plan is not a big group of people, so being off by one person makes a huge difference. She also presented the results of the Buck experience study for the PERS withdrawal rates - the likelihood of people leaving employment during any given year and age. Aon's replication data was a great match, leading them to believe that what Buck is doing is accurate. Graphs of the PERS unreduced retirement also demonstrated that the lines for the Buck and Aon data were closely banded, close enough that Aon felt it was not worth further investigation. Aon is confident that Buck's experience study results for PERS unreduced retirement are good. Lastly, she showed the TRS post retirement mortality numbers.

MR. FORNIA stated that every year an actuary tells a retirement system what its costs are based on the assumptions that they have developed, either from experience studies or from their best judgments. Aon Consulting duplicated Buck's actuarial valuation for both the pension benefits and health care. The differences between Buck and Aon's work was 0.17% on the actuarial liability, 1.14% on the normal cost, and 2.4% on the health care. All fell within the 5% tolerance, and Aon is satisfied. MS. REDDING pointed out that the 6.27% difference in the National Guard plan pension numbers is so small in dollars that there is no value in trying to track it down much closer than that.

MR. FORNIA concluded by saying that he has done a lot of actuarial audits, and this is one of the closest matches, especially in the valuation. He said Aon gave Buck Consulting the audit report to review, which included about a dozen comments on minor issues they thought Buck should look at.

MR. BADER stated that he and Ms. Hall reviewed the first draft of the report that Aon submitted to the Division of Retirement & Benefits and had a few questions that Mr. Fornia answered. Mr. Bader and Ms. Hall talked to Mr. Slishinsky at Buck, who did not believe there were any major items in the audit findings that were troubling to him. Mr. Slishinsky will have a formal response to the audit.

In reference to Mr. Fornia's earlier comment that given the aging population in the retirement plan it might be worthwhile to cease using the 25-year amortization of the unfunded liability, MR. O'LEARY said he understood that contributions were based on total payroll, which includes people who are not defined benefit recipients under the plan.

MR. FORNIA stated that the GASB rules does not allow determination of contributions based on total payroll. Eventually the Alaska plan will flunk the GASB test and not be in compliance because what Alaska is calling payroll will be half what the accountants are calling payroll. The other part is more theoretical. The people in the retirement plan hired 2006 and before will be fairly well along in their careers in 30 years, and the money in the fund will be for them and for the people who have already retired. It makes less and less sense that taxpayers should be paying the cost of the benefits for those people beyond a certain period.

MR. O'LEARY said an easy way to solve that would be to say there is a finite end to the unfunded liability, and it will be amortized to that time. But the volatility of contributions during the last ten years of that period mask *[sentence not finished]*.

MR. FORNIA said that frozen plans have put in place a ten-year minimum. He added that the contributions will be volatile but it will be on a tinier group. He clarified that these were just things that Aon recommended that the actuary look at because if Alaska keeps on doing the 25-year amortization some weird things are going to happen.

VICE CHAIR TRIVETTE asked how actuaries deal with the Judicial Retirement System that automatically raises the pension benefit for retired judges when active judges get a pay increase, when no one can predict how often the increases will occur. MR. FORNIA replied that actuaries study salary growth and develop an assumption of what an active judge will get in pay increases periodically. Then they use that same assumption for what the retired judges are going to get. So even though the pay increases are very choppy, the actuaries use a very smoothed method.

VICE CHAIR TRIVETTE said the board gets figures from either the state's primary actuary or secondary actuary, and they will say something to the effect that "mathematically here are the figures, but to be a little on the conservative side we will add a bit more here." He asked if actuaries ever state the facts and tell plan sponsors what numbers they should use and the reasons behind those numbers.

MR. FORNIA replied that it is important for the board to ask questions because the plan sponsor needs to know what the actuary is building in that they don't know about. The opposite can happen when the actuary tries to make the plan sponsor happy so they want to make the numbers low. For example, maybe the actuary is doing an 8.25% investment rate because they think the plan sponsor wants to do 8.25%, when maybe the plan sponsor doesn't. Part of Aon's job was to check that: they believe for the most part that Buck's assumptions are pretty close to their best guess. On the health care side there are a couple of areas where Aon believes that Buck was being a little on the conservative side. But Buck is being fairly realistic and doing what a typical actuary does, which is build in a little bit of conservatism.

MS. REDDING stated that Aon knows that in four years' worth of data there is always a story behind what happened in any given year. Aon does not trust that that experience would be replicated exactly in the future, and they try to be a little on the safe side.

MR. FORNIA stressed that the board wants to know if the actuary is being a little on the safe side or way on the safe side — or if they are being on the aggressive side. Aon believes Buck is being a little bit on the safe side, which is what Aon would recommend.

VICE CHAIR TRIVETTE said that he has read some actuary reports and meeting minutes from the 1990s, before he was involved with this board. Sometimes the actuary reports were not what the actuaries said in person. He believes the actuary will give the real story in person about what fudge factor is built into the assumptions. He said he wanted to know the real figures and then if the actuary believes the figures should be adjusted somehow. He asked how Aon would handle that if they were the primary actuary.

MR. FORNIA replied that often an actuary does not want to represent too much of the conservatism in the written reporting, but the actuary wants to make sure the board understands how much adjusting they are doing. He assured Mr. Trivette that Buck's work does not have a lot of just-to-be-sure built in — Buck is being pretty honest with the board.

13. Global Balanced Fund Recommendation

MR. BADER reminded the board that several months ago he told them of staff's concern in being able to monitor some of the investment managers in the defined contribution plan. To do that monitoring, staff has put guidelines in place for managers to operate within. Staff monitors the monthly reports and compares the managers to indexes, sector weights, capitalization weights, as well as metrics for fixed income. Capital Guardian Trust Company runs a global balanced fund investment option for the ARMB's participant-directed plans. Staff talked to them about the difficulty in monitoring the fixed income investments and proposed that Capital Guardian operate within certain guidelines. Capital Guardian was unable to respond in a way that would lead to an agreement with them. Staff then contacted other global balanced fund managers about the possibility of them providing that service to ARMB. State Street Global Advisors (SSgA) came up with a proposed global balanced investment option that Callan Associates reviewed.

ZACH HANNA gave a short slide presentation prepared by SSgA about the details of their global balanced strategy. The product is 60% equity and 40% fixed income. The benchmark would be 60% the Morgan Stanley All Country World Index for the equity component. The 40% fixed income component would be in two pieces: 30% the Barclays Aggregate Index for the U.S. fixed income part, and 10% to the Citi World Government Bond ex-US Index. Rebalancing will be done quarterly. To meet that benchmark, SSgA will work with a number of building block commingled funds (that are non-securities lending funds). The balanced strategy is really a passive fund made up of the pieces that compose the benchmark. The equity piece is the only one that differs because SSgA does not have a non-lending All Country World Index available to ARMB, so it has to be made up of slightly different pieces. The global balanced strategy's expected return should be the same as the indexes over time.

MR. BADER read staff's recommendation contained in the written report in the meeting packet.

MS. HARBO <u>moved that the Alaska Retirement Management Board terminate Capital Guardian as the global balanced fund manager and hire State Street Global Advisors to manage a global balanced investment option for the ARMB participant-directed plans</u>. MR. RICHARDS <u>seconded</u>.

<u>Roll call vote</u>
Ayes: Williams, Richards, Kreitzer, Harbo, Galvin, Erchinger, Schubert, Trivette
Nays: None

The motion passed unanimously, 8-0.

14. Investment Actions

A. Asset-Liability Study Recommendation

MR. BADER requested board permission to have Callan Associates, Inc. conduct an asset-liability study. Staff handed out a short report prepared by Callan entitled "ARMB Asset Liability Study Background" *[copy on file at the ARMB offices]*. That report stated that "...defined benefit plans should periodically undertake a comprehensive asset liability study. Such studies link a range of potential asset allocation policies to the plan's unique demographic and liability features. Such integrated studies...help decision makers better understand the consequences of changes in investment policies and explore questions such as contribution sensitivity, the range of funded status volatility and emerging liquidity needs. The last study conducted for the PERS and TRS programs pre-dates the formation of the ARMB and the shift to defined contribution programs for new hires."

MR. BADER asked the board to authorize an asset-liability study, adding that the budget contains about $40,000 per plan for this item.

MS. HARBO <u>moved that the Alaska Retirement Management Board authorize an asset-liability study to be conducted by Callan Associates, Inc.</u> MR. RICHARDS <u>seconded</u>.

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

B. Rebalancing Guidelines Revision - Resolution 2009-01

MR. BADER stated that at the last meeting the board expanded the bands for the real asset class in several funds. The severe decline in public equity markets without a mark-to-market capability in the real asset category gave a distorted view of the relative values of the different asset classes in the retirement plan. The resolution gives the investment staff discretion when evaluating the decision to rebalance within the bands prescribed by the ARMB and that the rebalance be delayed if, in the judgment of the chief investment officer, the cost of rebalancing exceeds the benefit of rebalancing. Staff always wants to be compliant with the board's policy, and in some cases they would like to delay the rebalancing decision until they can present it to the board. He asked that the board approve Resolution 2009-01, which makes that provision.

MS. HARBO moved that the Alaska Retirement Management Board approve Resolution 2009-01 relating to the rebalancing policy. MR. RICHARDS seconded.

COMMISSIONER GALVIN mentioned that the Alaska Permanent Fund Corporation (APFC) board had a significant discussion at its last meeting about rebalancing. The end result of that discussion was that rebalancing is a very important discipline that that board remains committed to, but that mechanical adherence to it could be detrimental to the Permanent Fund. The APFC board relies on its staff for judgment in making rebalancing decisions, and the staff wanted to ensure that the board would be aware of any decision to not immediately rebalance. ARMB staff's recommendation today is aligned with that same philosophy in that it recognizes the chief investment officer and staff can exercise judgment, with the underlying principles of the rebalancing policy remaining intact.

MR. RICHARDS said that bands around asset allocation targets are there for a reason. Regarding the term "mechanical investing," he thought the board would want to take the emotion out of the rebalancing decision. He has all the confidence in the investment staff, but sometimes there is a cost of doing business, and it is the board's fiduciary responsibility to ask why staff did not get out when something started to go. Staff's response could be that it would cost money to get out. The bands are there for a reason. He wondered what the exposure would be if an asset starts to go down the tubes, and selling would net pennies on the dollar, and it would cost money to get out of a contract. He asked about the history of this because he had concerns.

COMMISSIONER GALVIN said an important distinction is to recognize that the bands serve a certain purpose but they are not the asset allocation. The asset allocation is the targets. The board setting an asset allocation is actually advising staff to stay on target. The bands is where the board allows for some movement because of the ebb and flow of daily commerce. But the board wants action when an asset gets off target, not when it gets outside the bands. The board has to be aware when an asset is outside the bands and to question staff as to why they are allowing it to happen. There may be emotion or good reasons affecting it that the board has to be involved in the decision-making process. The total value for certain assets can be blurry because of the time lags associated with determining the value. So staff has discretion when looking at asset values on any particular day because they have to mentally adjust for movements in value that are not reflected in the statements. Even though it may look like an asset class is outside the bands, staff has to look at all the factors. Staff is able to explain to the board why an asset class was outside the bands for a particular period of time. For example, it is possible to be over the top band in one asset class but not be under the bottom bands on any other asset class. So there is going to be some discretion in how to rebalance. There is a false precision to the idea that the board can mandate when to rebalance. But the board can properly allocate responsibility for that decision-making, and the rebalancing policy is intended to define the role of the board and the role of staff. The proposed change in Resolution 2009-01 is recognizing the amount of discretion the board is bestowing upon staff and what the board is taking upon itself.

DR. JENNINGS stated that one of the ways that consultants and academics get precise is related to cost. The proposed change to the rebalancing policy says that staff will be judging the cost and benefit of rebalancing, and he saw that as appropriate. The marketability of certain investment instruments can change between the board's meetings, and that kind of discretion to staff is appropriate. If the cost went up, that is the kind of thing that would lead to the board's last policy revision, when it widened the bands around real assets. So given the rationale that the cost of rebalancing may be changing, the proposed policy change is reasonable.

MR. O'LEARY indicated he agreed with all the comments made.

VICE CHAIR TRIVETTE remarked that the change delays for one meeting, at the most, the chief investment officer notifying the board that some rebalancing has been delayed. However, the timing before board notification would be fairly short.

COMMISSIONER GALVIN stated that the APFC process is to notify the board at the end of each month if the asset allocation is out of balance. That allows for any board member to request a special meeting to talk about it.

MR. BADER explained that the ARMB's policy is not as process driven as the APFC's policy. Roughly weekly he gets an asset allocation status report from staff, and if the actual allocation is outside the bands investment staff makes the adjustment. He said that if the board grants the proposed authority to the CIO it would rarely be invoked. However, staff could make it a practice to notify board members by email about rebalancing actions taken: staff has no interest in hiding their actions. But staff is interested in not doing things that they feel the board would agree with them on.

MR. RICHARDS remarked that he agreed with everything that had been said, but his worry was about people not in the room today raising questions in hindsight, once an episode of delaying rebalancing has occurred. He said he did not want the board to expose itself to a breach of fiduciary responsibility because it might be six weeks before enough people to form a quorum could get together and review the situation. He did not want to put Mr. Bader and his staff in the difficult position of delaying rebalancing and trying to save money, and then having the asset value continue to decline. He hoped the provision would never be invoked, unless it was because the retirement fund was making too much money and staff wanted to save the system money.

MR. O'LEARY explained that when the asset allocation gets out of bounds it is because the asset that has gone down the most has shrunken to a percent of the total fund that is less than the minimum permitted under policy. So it is hard to visualize a situation in which not rebalancing would cause greater harm — in fact, rebalancing might cause the greater pain because it would be taking money from the asset category that has actually done better and moving it to the asset category that has done poorly. Actually, that is the appeal of rebalancing - to sell something that is relatively high to buy something that is relatively inexpensive. But the devil is in the details as to what the denominator is, and how liquid the market is. There were days in October and November 2008 when the cost of implementing a decision (getting 90 cents on the dollar instead of a dollar on the dollar because of the transaction costs) could have meant the asset category was no longer outside the bands. Or it might have been unrealistic to get a transaction executed in a timely manner. Those are the types of extraordinary situations that warrant the notification that staff is not doing things super mechanically but is using some judgment.

VICE CHAIR TRIVETTE mentioned that the record is clear that staff has called several special meetings in the last year because they needed to consult with the board. Staff has never hesitated to seek the board's direction when needed.

The roll was called, and the motion to approve Resolution 2009-01 passed unanimously, 8-0.

C. Equity Investment Guidelines Revision - Resolution 2009-02

MR. BADER stated that the equity guidelines currently are silent on the issue of whether the equity managers can hold warrants. Typically they do not, but sometimes there will be a stock dividend or another event that will result in holding warrants in a portfolio. The Treasury Division's compliance group in the Accounting

Section noticed this lack of authority to hold warrants, and so staff requests that the board revise the equity guidelines to allow equity managers to hold warrants.

MS. HARBO moved that the Alaska Retirement Management Board adopt Resolution 2009-02 approving the revised Investment Guidelines for Domestic and International Equities. MR. RICHARDS seconded.

VICE CHAIR TRIVETTE asked if there was any risk to holding warrants. MR. BADER said no, that the matter arose because there was $27 worth of warrants in the portfolio, and it would have cost more to sell them.

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

D. Barclays Funds Recommendation

MR. BADER reviewed the staff report included in the meeting packet. Barclays Global Investors manages an Intermediate Government Bond Fund, a Government/Credit Bond Fund, and an S&P 500 Stock Index Fund in participant-directed accounts for the SBS Plan, the Deferred Compensation Plan, and the PERS and TRS Defined Contribution Plan. Barclays engages in securities lending in all three of these funds. The ARM board has expressed its wishes not to be in securities lending funds, and Barclays now intends to offer non-lending funds for all three participant-directed options by March 31, 2009. Express board permission is needed for Barclays to transition from the current funds into the non-lending funds as soon as they are established. Staff will coordinate with the Division of Retirement and Benefits for the implementation.

MS. HARBO moved that the Alaska Retirement Management Board approve converting all the Barclays Global Investors participant-directed funds to non-securities lending equivalents. MR. RICHARDS seconded.

MR. O'LEARY stated he supported staff's recommendation. He added that several leading index providers have felt the marketplace pressures to also offer non-lending investment vehicles. Unfortunately, in some cases there is a cost associated with the transition because of the underlying securities lending program in the fund that they are in. He queried staff on how Barclays proposed to deal with that.

MR. HANNA said he did not believe there would be any additional costs to transfer the assets.

MR. O'LEARY said he wanted to alert the board to what could be a stumbling block in the timing of the implementation. If a fund had done securities lending, the securities that are on loan are collateralized, the collateral gets invested, and the collateral pool has a market value below or above the securities on loan. So if there were a run of people doing this conversion, those that remained in the lending fund would be disadvantaged. Then whoever was the trustee of that fund would presumably have breached their responsibility. They could do it if the people who took their money out took their haircut on the lending pool. He encouraged the board to accept the recommendation but to be aware that it may take a while to get the transition implemented.

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

E. General Consultant RFP Evaluation Committee

[The staff report was a handout at the meeting]

MR. BADER reported that the ARMB is soliciting proposals for investment consulting services. Two contracts will be issued - one with the ARMB for the retirement plans and the other with the Treasury Division for the endowment trusts. Under the ARMB regulations, the board chair has the authority to appoint an evaluation committee comprised of trustees and staff. Given the nature of the joint procurement, it seems advisable to have at least a three-member selection committee, including the Department of Revenue chief investment officer. That is because the consultant will provide services not only to the board but to the Department of Revenue. Staff conferred with the board's attorney, Rob Johnson, who recommended that the board take action to allow the chair to appoint a committee to evaluate the proposals.

MS. HARBO <u>moved that the Alaska Retirement Management Board allow the chair to appoint a three-person committee consisting of ARMB trustees and staff to evaluate responses to the general consultant request for proposals and report a recommendation to the full board</u>. MR. RICHARDS <u>seconded</u>.

MR. BADER said he expected the committee to make its recommendation to the board at the April 23-24 meeting.

COMMISSIONER GALVIN indicated he would abstain from participating on this matter because the General Consultant RFP Evaluation Committee would be making a recommendation to him in his capacity as Revenue Department Commissioner.

<u>Roll call vote</u>
Ayes: Harbo, Kreitzer, Richards, Williams, Schubert, Erchinger, Trivette
Nays: None
Abstain: Galvin

The motion passed unanimously, 7-0, with one abstention.

VICE CHAIR TRIVETTE announced that Chair Schubert had appointed him, Ms. Harbo, and Mr. Bader to the RFP Evaluation Committee.

MR. BADER added another item to Investment Actions.

F. Coventry Real Estate Fund II - Additional Funding Request

[The staff report was a handout at the meeting]

MR. BADER reported that the ARMB has $55 million invested in Coventry Real Estate Fund II. The commingled fund has 12 assets: some are performing assets, while other assets have loans that have come due for payment. The fund has also cross-collateralized some of those loans so that if the asset securing the loan is not sufficient to pay off the loan the lenders have recourse to the fund. Coventry has been very vulnerable to the economy, and the credit crisis has hit them substantially. Staff and other members of the Coventry Real Estate Fund II have spent a lot of time together and with the managing member discussing the fund's financial status. At this point, staff does not feel comfortable asking to make additional investments to the fund. In fact, the ARMB real estate advisor Townsend Group has advised against it until more information is available to make them comfortable about investing in the fund. That may happen at a time when the board cannot meet on short notice and it is necessary for quick action. Staff believes it is in ARMB's interest to have some dry powder available in the event that it becomes advisable to make investments into the fund. The recommendation is that the board grant the CIO the discretion to invest up to an additional $10 million into the fund, contingent upon Townsend's approval. Staff also requests that the CIO be given authority to approve the use of some funds for other items that may come up, such as legal fees, investment management fees, etc. — but not for the purpose of investing additional capital to buy property without the approval of Townsend Group. Currently, staff has no intention of using this authority, but markets move quickly now. Discussions with lenders take place and need responses quickly.

MS. HARBO moved that the Alaska Retirement Management Board grant the chief investment officer discretion to invest up to an additional $10 million into Coventry Real Estate Fund II, contingent upon Townsend Group's approval. Separately, the CIO may approve additional funds for ARMB's pro rata share of the cost for independent services to assist members in evaluating and addressing the current problems faced by the fund, as well as Coventry management fees. MR. RICHARDS seconded.

MS. HARBO asked if the request for additional funds was open-ended. MR. BADER clarified that the authority for the CIO to approve additional funds was included in the $10 million authorization but not part of any authority to buy property, which would require the ARMB's real estate consultant's approval. For example, investment management fees, appraisals, legal counsel, and investment advice, etc. would not require Townsend's approval.

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

15. Adoption of Trust Agreements

A. Resolution 2009-03 - Amended Alaska Defined Benefit Plan Retiree Health Care Trust Agreement

B. Resolution 2009-04 - Amended Alaska Defined Contribution Plan Retiree Health Care Trust Agreement

MIKE BARNHILL, Assistant Attorney General in the Alaska Department of Law, reviewed the staff report included in the meeting packet, calling this the latest step of what is becoming a multi-year tax compliance and accounting project. He said Resolutions 2009-03 and 2009-04 are amendments to the trust agreements the board adopted in September 2007 to establish separate PERS and TRS subaccounts in the new health care trust. The Internal Revenue Service (IRS) specifically requested these amendments. At a previous meeting the board heard discussion about the pension system's participation in Cycle C, which is a procedure that the IRS has implemented for public pension plans around the country to update the qualification status of the pension systems. The State of Alaska submitted its papers last fall, and the IRS is reviewing them. The IRS got back to the State's tax counsel, Ice Miller, which in turn advised the Department of Law that the IRS would like to see a handful of changes made to the retiree health care trust agreements.

MR. BARNHILL said the changes are relatively minor:

- The first is inclusion of a section in the beginning of the trust agreement that says that nothing in the trust agreement guarantees that the benefits provided by the health care trusts are tax-exempt. The point is that the IRS wants to reserve the right to determine tax exemption based on how the plans are operated.
- The second is explicit statements in the health care trust agreements that none of the assets of the trust will inure to the private benefit of anybody.
- The third is inclusion of a statement that only public entities can be participating employers in the pension systems. The Department of Law reviewed each of the 162 participating employers in PERS and the 58 employers participating in TRS and determined under federal income tax law that all of them are public entities under Section 115 of the IRS Code and thus qualified to be participating employers in PERS and TRS.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board approve Resolution 2009-03, adopting the Amended Alaska Defined Benefit Plan Retiree Health Care Trust Agreement, and Resolution 2009-04, adopting the Amended Alaska Defined Contribution Plan Retiree Health Care Trust Agreement. MS. HARBO seconded.

VICE CHAIR TRIVETTE commented that he did not like the IRS telling the ARMB that it cannot guarantee that the benefits paid from the trust will be tax free, unless the IRS tells the ARMB what it has to do to comply.

MR. BARNHILL replied that the IRS just wants the trust agreements to say that. He noted for the record that the letter from tax counsel Ice Miller states that the IRS has represented that these are non-negotiable items: it is either in there or the IRS will not continue to process the Cycle C requirement. He said he is not aware of any instance where the IRS has come to a public pension system and said with respect to the provision of health care benefits that they are not entitled to tax-deferred or tax-exempt status. He has discussed this with tax counsel, and they find it inconceivable that the IRS would do that if the pension plan is making a good faith effort to comply with the Internal Revenue Code.

VICE CHAIR TRIVETTE asked if Mr. Barnhill knew if there had ever been an issue with anything that has been done for the state pension plans that would be a problem. MR. BARNHILL replied that Ice Miller was particularly concerned early on about the commingling of the pension and health care assets. Once that was brought to the state's attention, legislation was enacted to separate the assets. He said his sense — and Mr. Johnson has made this observation as well — is that in terms of Internal Revenue Code compliance Alaska is doing pretty well compared to other public pension systems in the country. By bringing Ice Miller into the picture, Alaska is head and shoulders above many systems in the country.

VICE CHAIR TRIVETTE asked if Mr. Barnhill thought the board was ignoring its fiduciary responsibility by putting the amendment [about the tax status of the benefits] into the trust agreements. MR. BARNHILL said not at all.

<u>Roll call vote</u>
Ayes: Erchinger, Harbo, Kreitzer, Richards, Williams, Schubert, Trivette
Nays: None

The motion passed unanimously, 7-0. [Commissioner Galvin had excused himself from the meeting a few minutes earlier.]

MR. BARNHILL reported that one of the things the state is trying to obtain from the IRS as part of the Cycle C is written approval to transfer units from the pension funds to the health care trusts. The IRS has given verbal approval, but because of the Cycle C filings and the IRS's desire to see the amendments that the board just approved in writing, the state is still waiting for written approval to make the transfer. Hopefully, that will come within this fiscal year. The verbal approval was to move about $4 billion from the defined benefit pension funds to the defined benefit health fund trust. With Mr. Bader's and Treasury Division staff's assistance, the Department of Law has come up with a valuation formula to do that so it is fair.

C. Resolution 2009-05 - State of Alaska Retirement and Benefit Plans Trust Agreement

MR. BARNHILL stated that by adopting this resolution it formalizes the trust structure for the existing investment account into which almost all of the pension fund assets are pooled for purposes of investment. For all intents and purposes, the account has been a trust since its creation, but to make the whole system consistent the Department of Law and Ice Miller believe it is advisable to formalize it as a trust and establish a trust agreement, very similar to the trust agreements for the health care fund trusts. The draft trust agreement, which Ice Miller reviewed, was attached to Resolution 2009-05.

MR. BARNHILL said that a primary benefit to formalizing this structure is that apparently some investment managers have been confused by the structure of the Alaska pension systems and have asked questions about who the real investor is when they are accepting State of Alaska pension fund money. This is important with respect to whether the investor in question has sufficient assets to be a qualified investor for buying non-registered securities. The Department of Law would like to establish with certainty that the investor is the State of Alaska Retirement and Benefit Plans Trust, which has approximately $15 billion in it, and that there is no question that it is a qualified, sophisticated investor that can buy non-registered securities. This should aid staff in their communications with investment managers as to what exactly the investing entity is.

COMMISSIONER KREITZER <u>moved that the Alaska Retirement Management Board approve Resolution 2009-05, adopting the State of Alaska Retirement and Benefit Plans Trust Agreement</u>. MS. HARBO <u>seconded</u>.

The motion passed unanimously, 7-0.

MR. BADER commented that this has been the product of a lot of years of work and he appreciated Mr. Barnhill's patience throughout and the board's approval of the resolution.

MR. WILSON stated that having worked for a large pension plan that spent some time on this issue, his research showed that very few people were spending any time on it. He thought the State of Alaska's efforts were definitely leading edge.

VICE CHAIR TRIVETTE asked Mr. Barnhill to let the board know if there was anything it had to do to make sure the plan members are protected. MR. BARNHILL said he thought everything was fine.

RECESS FOR THE DAY

VICE CHAIR TRIVETTE recessed the meeting for the day at 5:12 p.m. Chair Schubert, Mr. Williams and Ms. Harbo indicated they would be absent the second day.

Friday, February 13, 2009

CALL BACK TO ORDER

VICE CHAIR TRIVETTE called the meeting back to order at 8:32 a.m. on Friday, February 13. Trustees Erchinger, Galvin, Kreitzer, Richards and Trivette were present.

REPORTS (Continued)

16(a). State Street Bank and Trust Company

LISA TYRRELL, MARK SHAFER and DAX JOHNSON of State Street Bank, the custodian and book of record for the pension funds, made a presentation to the board. *[A copy of the State Street slides is on file at the ARMB offices.]*

MR. SHAFER stressed that State Street is a specialized bank focused on two components to service institutional customers: investment management and investment servicing. From an investment management perspective, State Street is the largest institutional asset manager, with about $1.7 trillion under management. State Street is also the world's leading investment servicer, with approximately $14 trillion in assets under custody. The investment servicing division generates about 84% of the bank's revenue and is continuously reinvesting in new products and new services. State Street's size means they can share the experiences within their customer base with the ARMB so the board's staff can benefit from what is changing and what is new in the industry.

MR. SHAFER stated that State Street's expertise has been tapped in recent government initiatives. They were appointed to manage some of the mortgage-backed portfolios for Fannie Mae and Freddie Mac; they are involved in the AML program, which is purchasing asset-backed corporate paper from money market funds; and they are involved in the CPFF program, which is a corporate paper relief fund that is helping bring some stability to the markets. State Street also has a very strong understanding of GASB - both current and future initiatives that are coming, and works closely with GASB by giving opinions as well as trying to develop solutions in what GASB is initiating. State Street understands the ARMB's need to control risk and monitor performance, and offers tools to help with investment policy compliance.

VICE CHAIR TRIVETTE asked if State Street has any plans to cut back on staff because of the financial crisis. MR. SHAFER responded that the financial situation is impacting basically everyone in the industry. State Street is looking to cut about 1,600 jobs globally; to date, they have eliminated about 850 of those jobs. They are not just letting the bottom level jobs go but are cutting across all levels, including executive vice presidents and senior vice presidents, looking to do more with less up top. He said the people appearing today will be the ones the board will see on the relationship going forward, and the cuts should have no impact.

VICE CHAIR TRIVETTE said the board has heard about some issues with certain GASB regulations. He inquired if State Street is proactive in working on those standards or if they just deal with what comes out. MR. SHAFER replied that State Street will be meeting with GASB in a couple of months to talk about some of the new initiatives on derivative valuations and how to peg that off against hedges versus non-hedged assets. They will be discussing what a custodian bank can provide and how GASB can adapt the regulations to make it easier for the reporting process. So there is an open dialogue between GASB and State Street Bank. However, when the Governmental Accounting Standards Board makes their decision, everyone will be stuck living with it, regardless of the bank being able to give an opinion.

MS. TYRRELL talked about State Street's client service approach next. She is the Treasury Division staff's liaison for all the investment services at State Street. For example, the trust structure that the board approved yesterday is something she will be working on with State Street's financial information services team, as well as the global custodial network and the legal team. She keeps Treasury staff informed of new products and enhancements. One new enhancement to the online reporting tool is some additional class action reporting features coming out in a couple of weeks. If there are conflicts or blips in the ARMB's relationship with State Street, she is the contact person who has an overall view of things and can quickly resolve problems. She makes sure the ARMB's goals and needs are being met, and to that end she conducts a service evaluation annually.

MS. TYRRELL briefly reviewed the milestones in the relationship between the Alaska pension fund and State Street since 1991. She said the latest change was the move toward providing daily pricing.

VICE CHAIR TRIVETTE asked if the conversion from monthly to daily compliance monitoring was costly for ARMB. MS. TYRRELL said no, that State Street included the daily compliance in the last contract negotiations with the state. The move to daily compliance monitoring is still continuing, and it is done weekly right now.

MS. TYRRELL stated that among all the services State Street provides, the two most significant service areas are the financial information services and the State Street investment analytics. She reviewed the financial information services, and Dax Johnson followed up by explaining the investment analytics.

Financial information services cover the custody and accounting functions that State Street does for the Treasury Division. The complexity of the retirement funds warrants the state taking advantage of the bank's most sophisticated services.

MR. O'LEARY remarked that recently there has been heightened activity in the equivalent of class actions internationally, but the structure is different outside the U.S. He asked how

State Street monitors those sorts of international claims. MR. SCHAFER replied that the monitoring is build upon the same premise as the domestic class actions. State Street gets information feeds from three or four vendors, and they also search newspapers and get local information from the subcustodians. The process is a bit different than domestic class actions, but it fits into what they already do. State Street files on behalf of all their customers internationally as well as domestically.

MR. O'LEARY mentioned that he has encountered situations where investors have to expend some money in order to have standing in an international class action. MR. SCHAFER stated that if State Street had to expend money they would talk to the State of Alaska first. At this point, they have been filing without it being an issue. MS. TYRRELL added that certain countries have separate guidelines for class actions, and she would contact the Treasury Division if that were the case.

MR. ROB JOHNSON inquired if State Street provides any services regarding information on bankruptcies in the U.S. or abroad, particularly with respect to when creditor claims need to be filed. MS. TYRRELL replied that State Street receives notifications of bankruptcies and categorizes them under corporate action services. They check to see if any customers hold that issue and then notify the investment manager through the corporate action system. State Street is not in the best position to follow a bankruptcy because they do not have all the data. There has not been many large bankruptcies to this point, but that could change.

MR. SCHAFER stated that Lehman Brothers is a prime example, where the exposure was not only from an investor holding a bond but possibly having collateral or an open trade that was unresolved. At that point, they really need the investment manager because they will know all the moving parts of what is still outstanding. State Street worked with the managers to make sure they had all the information they needed and were able to actually file. State Street checked back with managers to inquire if they filed for their clients, because they felt an obligation to chase it.

MS. TYRRELL described how State Street interacts with a lot of different groups: portfolio management, asset accounting, and cash management at the Treasury Division; T. Rowe Price Trust Company regarding the Alaska Common Trust Fund; ARMB's external investment managers; Great-West Retirement Services; Callan Associates; external auditors; and periodically the state's Division of Retirement and Benefits.

MS. TYRRELL reviewed the current projects and what is coming up:

- Corporate governance - enhance class action reporting, some additional proxy reporting, and pulling everything together into a corporate governance dashboard.
- Over-the-counter derivatives hub - the ARMB is not currently in derivatives, but a lot of other public funds are going in that direction. The hub will allow for straight-through processing, and will give improved reporting, transparency, and risk

analysis.

- Accounting and reporting for the new investment options, including target date funds.
- Conversion to Alaska trust structure.

MR. BADER commented about increasing criticism of the unregulated parts of the investment industry. He asked if State Street has been involved in any talks with federal regulators about developing regulations for swaps and other derivatives that would give funds like ARMB more comfort about getting into this area. MR. SCHAFER replied that he was not sure that State Street has been involved in any discussions about regulating derivatives, but he would check and get back to staff. He added that the industry itself is trying to move toward standardization, which is part of what the State Street OTC derivatives hub will be driving to make the transactions more transparent.

MR. DAX JOHNSON gave an overview of the State Street investment analytics structure, which combines the performance, analytics, compliance, and information delivery groups. All these services are delivered through the "My State Street" platform. He also described the current services the bank is offering: rates of return computations; results comparison; analysis and risk comparison; trade cost analysis; investment compliance; and market commentary on a quarterly basis. State Street also offers a lot of services in the alternative investments space that Alaska is not using currently - investment monitoring and due diligence, calculating specific performance returns on private equity, as well as real estate and hedge fund information.

Noting that real estate returns are lagged, MR. BADER asked what State Street is seeing as far as writedowns in the last quarter. MR. DAX JOHNSON said they have not seen a lot of real estate data for December yet, but there are some significant writedowns out there. He added that everyone is interested in what comes out, because, like this board, they are concerned about their asset allocations and rebalancing.

MR. DAX JOHNSON reviewed current projects related to ARMB in the investment analytics area:

- Investment compliance - rebuilding the compliance tests based on updated investment guidelines; transitioning from monthly to daily reporting; and discussion of the Sudan review and potential solutions for monitoring.
- Consolidating and improving performance reporting.
- Rolling out the global performance analytics dashboard.

COMMISSIONER GALVIN stated that the Sudan divestiture bill under consideration in the Legislature is structured to provide the commissioner of revenue with the discretion to establish a list of companies doing business in Sudan in which Alaska public funds cannot invest. Once the state list is established, State Street will report on if the funds are in compliance.

MR. DAX JOHNSON reported that a priority of State Street information analytics over the past year is to create an internal data warehouse that pulls together information they have access to, starting with accounting data and performance results, as well as market data on benchmarks and information specific to securities. The data warehouse is starting to reach maturity in the sense that State Street has daily and monthly performance currently on there, as well as security level characteristics. This project will continue to be a priority throughout 2009 as they add more content across the product set, incorporating attribution, portfolio level and composite level characteristics, risk statistics, private equity and real estate, and universe information. One of the main advantages to the data warehouse is that it gives State Street scalability to incorporate all the content with a lot less system development that it did in the past. The primary benefit to clients is the dashboard the bank is building on top of the data warehouse. Clients will be able to view the information across portfolios, as opposed to the report-driven process used currently. State Street is moving from a report-generating model to a data-centric model, giving the user the capabilities to do what they want with the data.

MR. DAX JOHNSON presented a graphical example of what the interactive dashboard looks like. The Alaska roll-out is expected mid-year.

MR. SHIER asked if State Street had any plans to make the dashboard available to individual investors who are in a client group. MR. DAX JOHNSON said not at this point, that they are focused on the institutional level. MR. SCHAFER added that if the State of Alaska wanted to give the interactive dashboard capability out to plan participants State Street could work with the state on that, perhaps through a separate web site the participants could link to. MR. SHIER said the retirement plan has some participants who are very interested in seeing performance on a more periodic basis. The Division of Retirement and Benefits has worked with the state's recordkeeper, Great-West, to provide tools to get fresher data into the displays that are available to participants. He said he was not really requesting a service from State Street, but it was something to think about.

16(b). State Street Global Advisors (SSgA)

NEIL TREMBLAY and GAURAV MALLIK appeared before the board to talk about the several index funds and the international alpha strategy that SSgA manages for the retirement fund. *[A copy of the SSgA presentation booklet is on file at the ARMB office.]*

MR. TREMBLAY first gave a quick update on the firm, which managed $1.4 trillion as of 12/31/08. Those assets are down about 26% from one year ago. The organization remains extremely profitable, which allows them to reinvest and to pay their people to stay, which in turn creates stability for Alaska. SSgA has participated in State Street's overall workforce reduction program announced in the fall of 2008. SSgA eliminated about 150 jobs over several months from the top to the bottom of the organization, trying to do more with less people. They do not anticipate further layoffs, but he could not say for certain there couldn't be because no one knows what the markets are going to do over the next year. SSgA also exited a few businesses, for example, the fundamental equity shop within State Street for 20 years that was a legacy from when they were managing private wealth as a trust bank in Massachusetts. There has been no turnover in the teams with whom the Alaska retirement fund works - on the passive side, or on the active international side, or on the asset allocation side.

MR. TREMBLAY talked about personnel changes at SSgA. A new president and chief executive officer, Scott Powers, took over in mid-2008. He had been CEO at Old Mutual Asset Management. Mr. Powers spent time observing SSgA for about three months before making some changes. The most important change that relates to Alaska was splitting the risk management and compliance functions into two separate groups that report directly to Mr. Powers. This has been positive, with a better overall ability to monitor what is going on with State Street, because it is an extremely large organization. Systems and personnel are being put in place to help monitor the portfolios to make sure they stay in compliance. Also, from a risk standpoint, to see how SSgA is actually managing assets to make sure there are not risks in a portfolio that they cannot identify. That aspect is directly relevant because if SSgA had had something like that in place, he believes they would not have had the issue they had in fixed income a few years ago. Mr. Powers also named a global chief investment officer, Rick Lacaille. In 2007, SSgA moved to an asset class chief investment officer structure so the CEO could reduce the number of people reporting directly to him and be able to focus on issues. Mr. Lacaille was a chief investment officer in Europe when SSgA had a regional structure, and is based in London, fortifying the global aspect of the organization.

MR. TREMBLAY stated that SSgA manages eight passive strategies for the retirement fund through its global structured products group. SSgA is managing the active international strategy in seven locations: these centers are linked and working off the same portfolio management systems, and the same compliance and risk management systems. They have a 24-hour trading desk between Hong Kong, London, and Boston. SSgA is in the process of converting to a new compliance system, of converting to a new recordkeeping system, and in the process of converting to a new performance and reporting system. All this should allow them to better deliver the basics to the asset accounting group in the DOR Treasury Division quicker and more accurately.

MR. TREMBLAY gave a brief overview of the SSgA relationship with Alaska that encompasses the Alaska retirement fund and non-retirement assets totaling $4.8 billion. He said SSgA has not met the ARMB's expectations for the active international alpha strategy, and Gaurav Mallik, a senior member of the active international group, would discuss that in detail.

MR. MALLIK stated that he is clearly disappointed that they have underperformed in the international alpha strategy and that the portfolio is down 61 basis points relative to the benchmark since inception. Much of the loss came starting in the fourth quarter of 2007 and building up to 2008. This has been an extraordinary time, especially for systematic risk control strategies like SSgA's, in that the market has moved very fast based on macro uncertainty rather than stock fundamentals. In the fourth quarter of 2007 it seemed to everybody that the problems on the credit side and with subprime were very localized problems that would only effect the U.S. economy, and that much of the world would be okay. There started to be an extreme divergence in performance between value industries (the clear staple industries that are more focused on the domestic economies) and the global cyclical industries (energy, materials, and information technology).

MR. MALLIK said that starting the first quarter of 2008, people were still thinking it was a U.S. problem that would not affect the rest of the world. Then there were very strong actions from central banks in January 2008. Consequently, the themes that SSgA saw in the fourth quarter of 2007 continued well into the first two quarters of 2008. In July 2008, the gross domestic product (GDP) numbers from Germany, Italy and Spain were very bad. People then said the rest of the world was going to suffer even more than the U.S. So in the last five quarters there was initially a massive run-up in growth-oriented cycles, and then a marked change in a very short period of time. One example is that oil traded at $147/barrel on July 15, 2008, by July 31 it was down to $100, and at the end of the year it was about $40.

MR. MALLIK explained that quantitative strategies by their nature are dependent on trends being in the marketplace. When there is such a marked shift, strategies like SSgA's face some temporary dislocation. Clients have asked when SSgA has experienced this before, but what happened in the last five quarters is clearly unprecedented. However, they can look back at periods of similar dislocations but maybe for not as long a period of time. Within international alpha, which has a track record that goes back to 1998, SSgA saw dislocations in Q4 of 1998, when there was a severe credit illiquidity crisis in the financial markets. The international alpha strategy underperformed in Q4 1998 by approximately 300 basis points. The strategy recovered from that until the fourth quarter of 2001, when another extreme dislocation in the market occurred. In each of these periods it was tempting to say throw everything out and start fresh again, but eventually the market does return to some normalcy. Given that the SSgA international alpha strategy is a risk control strategy, they are not going to knock the lights out when markets are doing phenomenally, and they are not going to go down dramatically when markets are down.

MR. MALLIK said that over the last year the strategy was down about 144 basis points relative to the benchmark. However, they have already seen a good return from things they have changed in 2008. Year to date, the strategy is up about 80 basis points relative to the benchmark, and they hope it continues.

MR. MALLIK explained that SSgA picks stocks that are relatively cheap in the marketplace, driven by value indicators that have worked well, and there is no reason to believe those will not work in the future. However, they recognize that there is a need to round the signals out so that in extreme periods there is some cover. Recently they have focused their efforts on signals like introducing something on default risks, so that in extreme periods of credit problems, they can adjust the positions a little bit. In Japan, which is a key part of the international alpha strategy, SSgA looked at the model and felt there were some signals that were not working anymore, that had been arbitraged away. So they replaced some of those signals in the first and second quarters of 2008. They also recognize that they need to look at more sources of information to generate signals, and SSgA has the size and scope to do these things. They know if they design signals that are driven off the data that State Street has, it will be very tough for anybody else to arbitrage that.

MR. MALLIK gave a brief overview of the international alpha strategy, which seeks to provide 2% of excess returns over the MSCI EAFE Index with a tracking error of 2% to 3%. Through this period of extreme turmoil SSgA has not seen the tracking error or risk parameters explode. This is a core strategy, so they are not looking to make any big moves on any sector, country or region. The portfolio sector weights are still tight to the index. So even in a sector like financials that has been a disaster, the portfolio still has a 20% allocation because the benchmark has a 20% allocation. The financial sector has been problematic for SSgA through this period. The portfolio is overweight on defensive sectors: consumer staples, health care, telecommunications, and utilities — a reflection of the way the market is and where SSgA sees a lot of opportunities.

MR. MALLIK said that when SSgA sold the international alpha strategy to the ARMB they committed that they would be able to construct a portfolio that is cheap relative to the benchmark and a portfolio that should have better prospects than the benchmark. The price/earnings, price/book, price/cash flow, and dividend yield characteristics indicate a strategy that is pretty close or a bit cheaper than the benchmark. The growth indicators show that on average the strategy is a little bit more growthy than the benchmark. SSgA believes that over the long term, if they can consistently deliver on this, the portfolio will be rewarded in the marketplace — even though there can certainly be hiccoughs going through the market cycle. The portfolio's market capitalization is very tight to the benchmark. Finally, there are about 396 stocks in the strategy out of a universe of about 989.

MR. MALLIK said the strategy holds positions in most countries and most regions, with no massive overweights or underweights in any particular region. The biggest overweight is Switzerland because some of the pharmaceutical companies and banks are located there. Another overweight is Belgium, and that is because of holding Anheuser-Busch InBev.

Moving on to the market review, MR. MALLIK said 2008 was a tumultuous year for world equity markets. He said his expectations at the end of 2007, along with most of Wall Street, were that 2008 would be a year when growth would outstrip value. For example, at the start of 2008, Goldman Sachs had a target of $200 per barrel for oil. Energy and materials gave positive earnings in the first six months, but there was a dramatic turnaround in the second half of the year. Such a violent rotation in a particular sector means it will take time for a risk averse strategy to catch up.

MR. MALLIK said he wished he could state that this was the end, but the view from SSgA economists and others is that global risk is still skewed to the down side. So what started in the fourth quarter of 2007 will continue in the first and second quarters of 2009. The credit problem is getting bigger and affecting more things. The hope is that the coordinated efforts to provide fiscal stimulus across the globe will result in some abatement, and that there might be a turnaround toward the end of the year. Stock markets tend to lead the economy by about six months, so the stock market could perhaps be positive in the latter half of the final quarter of the year.

Clearly sectors had a big role to play, but one of the other problems the international alpha strategy encountered in 2008 was that individual stocks moved very dramatically. MR. MALLIK said the overall performance of the model was weak in the last half of 2008. They do see some spark in that the level of the model's underperformance has come down. Another problem generally not seen was the strong negative correlation between cash earnings to price and ETI - an earnings metric proprietary to State Street that basically looks at what analysts expectations are. So buying a cheap stock meant a company with poor growth prospects, and a company with good growth prospects would be expensive. SSgA is seeing all those trends decline through January, but it has been a different problem than they have seen in the past.

MR. MALLIK showed a graph of what has been happening with the factors compared to the overall performance of the model. On average, from 1998 until now the performance has been positive, and it has been positive very recently. The problem is that many of the other factors have not delivered, especially when it comes to valuation factors. For example, the measure of price to book adjusted for return on equity and the measure for forward earnings yield are extremely negative. As the economic situation deteriorated, analysts stopped trusting earnings numbers for firms, so they stopped using that metric in their consideration. Cash-based metrics have still held up, so cash earnings to price has worked somewhat. A measure of the amount of earnings that come from cash has worked reasonably well. If one factor is working well and another factor is not working well, you have to make sure that what is working is working well enough to compensate for the other factor. That has been a problem — when the valuation factor sank, it sank so deeply, even though every other factor was working fine, it dragged performance down.

MR. MALLIK spent a few minutes discussing the model and performance outlook. Many indicators are positive today. Looking at the valuation factor, SSgA is seeing an all-time high in dispersion for things like forward earnings yield and price to book. There is a such a difference between companies that are cheap and companies that are expensive. It is a matter of time before people try to arbitrage that mix away. So valuation should be working very soon. People are interested in companies with good financial strength, and SSgA has a factor that looks at long-term growth prospects of a firm. That is kicking in very nicely. Price momentum is picking up nicely, because they are picking up both the underperformance of weak companies and the outperformance of strong companies. That has been one of the strongest performing factors in January 2009, which is why the portfolio was about 80 basis points over the benchmark. Having gone through the trouble of the last year means a lot of foreign funds and hedge funds have exited the business, which means a lot of leverage has come down. Now everybody is not chasing the same thing, and that is positive.

MR. MALLIK stated that there are some signs that equities could provide positive returns in 2009. Dividend yields are higher than Treasury yields, which means investors can get a competitive income stream from stocks. A decline in prices has a good impact because it lowers valuation. Cash balances are at all-time highs, sitting on the sidelines, and people will go out on the risk spectrum a bit looking for higher yields than Treasuries. They could go to corporate bonds and then into equities. Non-U.S. equities continue to be fairly valued and a good place to be. The asset allocation group at SSgA thinks that equities will have positive returns in 2009.

Referring to a statement in the presentation material, VICE CHAIR TRIVETTE asked how investor pessimism was a positive for the equity outlook in 2009. MR. MALLIK said that SSgA has access to external research that indicates that whenever there are extreme levels of pessimism in the marketplace some investors will start investing and it starts the momentum.

MR. MALLIK stated that SSgA knows their investment process and model make sense. So while there is a down turn — and it is tough when the ARMB has given SSgA money to manage, they feel very confident that they will get out of this and should see aggressive returns to catch up, based on historical experience.

MR. BADER mentioned that in the last quarter of 2007 some people left the SSgA investment team to set up shop someplace else. He asked if SSgA has replaced all those team members. He added that the ARMB has stuck with SSgA for a year since then, and the portfolio return is below the index.

MR. MALLIK stated that they have completely rebuilt the team with people who are equal or better, because it was an opportunity to look at the whole team, and people were getting laid off from other firms, making it a great time to hire. As of July 2008 they were finished with rebuilding the team. They hired somebody from Citi Group, another from Goldman Sachs, and in Australia they got people from Barclays and Axim Rosenberg. While the international alpha strategy has lagged the benchmark return, across the group they manage a range of strategies, some of which the people who left SSgA decided to replicate. The performances of those strategies have been markedly different.

MR. BADER noted that a large part of the international alpha strategy underperformance inception to date came right before the team members left SSgA. He asked if SSgA would be put into the value or growth style bucket today. MR. MALLIK replied that they are core managers and do not sway to one side or the other. MR. BADER commented that all the metrics that Mr. Mallik showed tended to be on the value side. MR. MALLIK said that of the seven factors they use in the model, three are value factors and three are growth factors. Of course, if there is a period when growth outperforms value, they will get a bit more growthy, and vice versa. But they are very tightly constrained. If one were to plot the international alpha strategy on a quadrant, it would show that they are very core.

In closing, MR. MALLIK described what SSgA has been doing in research development. Their goal is to round things out so they are not holding stocks using factors that have been used by a range of other managers. They are also looking at proprietary signals, things like news-related signals. SSgA bought a data set from Dow Jones going back to 1980 to see if bad news or good news coming out about a stock tells anything about future performance. Another factor that went into the model last year was default risk: an observation last year was that companies that were cheap also had a significant amount of credit risk in them. This factor would only come on in certain time periods when credit was a big concern in the economy.

SSgA concluded their presentation. COMMISSIONER GALVIN distributed a draft resolution to support the Governor's version of a Sudan divestiture bill for board members to review and consider later in the agenda.

VICE CHAIR TRIVETTE called a scheduled break from 10:01 a.m. until 10:15 a.m.

17. TCW Energy Report

BLAIR THOMAS and CLAUDIA SCHLOSS of TCW Energy & Infrastructure Group made a presentation to the board on the TCW Energy Fund X and Fund XIV in which the retirement fund is invested. *[A copy of TCW Energy's presentation booklet containing additional background information, including descriptions of individual investments, is on file at the ARMB office.]*

MS. SCHLOSS stated that TCW Energy is a strong organization balance sheet-wise, although they too experienced some asset loss from the markets. There are no layoffs at the firm.

MR. O'LEARY asked for comment on the parent company of TCW Energy. MS. SCHLOSS said the parent company is Societe Generale, the second largest bank in France. The bank announced a merger with another French bank, Credit Agricole, that has not been finalized. This has not affected TCW Energy at all: in fact, they will probably be even more autonomous as a result of this development. MR. THOMAS added that Societe Generale has sold off the other pieces of their asset management business, excluding TCW. Part of the transaction will be implementing 30% ownership of TCW by TCW employees. That further augments not only the firm's autonomy but the alignment of interests as TCW shareholders, not just individual portfolio managers. They view it as a positive development.

MR. THOMAS spent a few minutes talking about the TCW Energy & Infrastructure Group, noting that they have the longest continuous record of any institutional manager in energy and have 14 prior funds. Current assets under management solely focused on energy are over $6 billion, making them one of the top two or three institutional investors in the energy sector. They have invested through multiple commodity and business cycles and have gotten good at dampening the volatility in those cycles. Obviously, that ability is being tested in the current market environment. On the mezzanine-focused fund activity, which is the lion's share of what TCW Energy does, they have delivered net returns of just over 14%. The equity portion of the portfolio has returns in the forties. TCW Energy is primarily credit investors in energy, and there is typically a 15% to 20% equity component in the portfolio. They have historically sought to deliver gross returns in the high teens and net returns in the mid teens, and have done that across 13 prior funds.

MR. THOMAS said that a lot of people got carried away with leverage in the last five years. The question will be how much of the returns in the last three to four years were really alpha and how much were just cheap leverage.

MR. THOMAS explained that TCW Energy's style dampens commodity price volatility:

- They use secure debt investments.
- They invest in energy broadly defined, not just a pure play on commodity prices.
- They use a fairly conservative price deck when making the investments; they do not make investments off of spot prices. For example, when oil peaked at $147/barrel, the highest their price deck ever got was $75. That number comes from the marginal cost of production of non-OPEC supply (tar sands, Gulf of Mexico, and offshore West Africa - all high cost environments).
- Commodity hedging. In the last two years they have hedged more than they had in the prior 20 years, because they did not believe what they were seeing.
- No leverage in the portfolio, so it does not amplify the mistakes.

MR. THOMAS reviewed the TCW Energy international investment team. The firm implemented FAS 157 and fair value reporting at the tail end of Energy Fund X, so they reported in both methods for that fund. In Energy Fund XIV the reporting has been solely FAS 157 compliant. In order to implement that, they added a person to the team who had been a senior manager at PriceWaterhouse working with FAS 157 implementation for energy companies on the west coast. The change to fair value reporting has been more challenging than anticipated, and it has had consequences beyond what most people anticipated.

MR. THOMAS described TCW Energy's strategy of investing in hard assets with a long useful life. Their market is the energy value chain — from the wellhead through spark spread. He reviewed the disciplined, value-oriented approach to investing. The key to their style is bottom-up technical analysis, secured investments - either by assets or shares, strong current cash flow, very active management through covenants and board participation, meaningful prepayment penalties, and getting upside through equity participation. Their competitors are a few other big franchise players, several specialists, and then generalists like hedge funds and public markets - a tier that is gone at this point. He also reviewed how even the sum of all TCW Energy's bad investments since they began have a gross return of 8%. An example is a power plant that has problems, but it is a 30-40 year useful life asset. If an investor has the patience and wherewithal to restructure the plant and operate it, ultimately there is meaningful recovery. That is why TCW Energy has a positive rate of return on the defaulted investments.

MR. THOMAS gave the details on TCW Energy Fund X, including the two investments that performed below expectations. The ARMB's commitment to Fund X was $80 million, and distributions to date are $83.3 million. Future distributions will take place as the portfolio has more investment realizations. The equity portion of the Fund X portfolio suffered and the equity return is not going to be particularly strong. Thankfully, that is a very small piece of the overall portfolio. TCW Energy has never had a portfolio where there were no mistakes. The forecasted internal rate of return (IRR) on the portfolio is 18% gross and 15% net, and they are looking at a 1.7 times return on investment. For FAS 157 purposes, they are carrying the portfolio at 92% of par. The debt values in the portfolio are relatively flat, and the equity and equity kickers are marked down 45%. They are not hiding any losses in the portfolio.

MR. THOMAS also reviewed Energy Fund XIV, noting that although the fund closed December 2007, the bulk of the activity for this portfolio was in the last 120 days of 2008 and into early 2009. Raising the commitments when they did turned out to be a good thing. Fund XIV has 23 investments and has had four realizations. The portfolio is 62% first lien investments in world-class projects and companies for rates of return that are in the high teens, low twenties. The ARMB committed $100 million and has received $12.3 million back in distributions so far. There is constant cash flow in TCW Energy's portfolios and no J-curve issue.

MR. RICHARDS asked if TCW Energy was happy with the sector diversity of the portfolios or might consider expanding into wind energy or more coal projects. MR. THOMAS said there is no hard formula. They are constantly looking at the market and deciding the best place to invest, both domestically and in other markets. Today, he is more bullish on the natural gas market in Australia than he is the natural gas market in the Lower 48 for the next 12 to 18 months. Two or three years ago, the only renewable energy TCW was doing was in Europe because the continent had adopted the Kyoto Protocol, and countries were much more advanced in terms of implementing the regulatory regime that supports renewable energy — recognizing that renewable energy is not cost competitive on purely commercial terms. Without that type of regulatory and fiscal framework to support it, a private investor would not invest in renewable energy because it will never be the low-cost provider. Fund XIV has one preferred investment that is the second largest wind developer in the United States. The investment was made in the fourth quarter of 2008, and it is not a coincidence that TCW is watching what is happening from a political and regulatory standpoint in the U.S. TCW Energy finally got comfortable that now is the time to pull the trigger on renewable energy in the U.S. Despite the investments being in a common sector, there is meaningful benefit from being in subsectors within energy. Fund XIV is the most diverse portfolio so far.

MR. THOMAS described a couple of investments in the Fund XIV portfolio to give a sense of what they can get done in the current market environment: a geothermal power project in Nevada, and an offshore oil facility in Western Australia.

Addressing oil and gas prices, MR. THOMAS said that oil, like a lot of things, became a financial asset onto itself in mid-2008 as massive amounts of hedge fund money moved into oil. Those in his industry a long time never really viewed oil that way, and they never thought that fundamentals drove oil up to $147. It was all leveraged, and leverage coming out of the system is what brought the price right back down. The strengthening of the dollar after mid-year also drove oil prices down. TCW Energy believes that is a temporary phenomenon and a function of flight to quality. Lastly, there has been demand destruction. Demand in the United States will be down 6% to 7% from its peak, although globally demand is about flat. There is still demand growth in China and some other markets, but it has slowed dramatically.

MR. THOMAS said his personal view is that the supply response to the crash in oil prices will be significant. The country has cut over $100 billion out of 2009 CAF X programs. In the last several years, the supply growth has come from unconventional sources, and unconventional requires constant drilling to keep the supply up. That drilling has now been significantly curtailed or stopped, and that will work its way through the system in 2009. When the economy finally starts to turn around, which he thought would be sometime in 2010, that is when the supply response will really show up. The best estimate is that there will be a fairly sharp snap-back in oil prices in mid-2010. The big variable is not on the energy side but what happens in the global economy. If the global economy does not bounce back in 2010, that snap-back will not happen until it hits bottom and is on the way back up.

MR. THOMAS said he is less bullish in the medium term on natural gas in the United States. The country has built a lot of regasification capacity for liquid natural gas (LNG) along the Gulf Coast and some other areas. Most of that is being unused right now. So through-put on the LNG terminals in the Gulf Coast is about 20% of capacity. As the global economy slows down, the recipients of that LNG — mostly in Asia and to a lesser extent in Europe — are taking less. The U.S. is going to become a storage facility for LNG in 2009 because they are still liquefying it. That is a temporary phenomenon, but it will delay the snap-back in prices for natural gas. He would push natural gas probably out a year past when there is a price response in oil.

COMMISSIONER GALVIN asked when TCW Energy sees the equilibrium point once the oil market gets back to fundamentals. MR. THOMAS said in five years a long-run price for oil in the $65-$70 range is reasonable. He thought the price would spike past that and then come back down to get some equilibrium. On the natural gas side, the $6.50 to $7.00 range long run is a good price, but he did not see getting to that level for two years.

VICE CHAIR TRIVETTE thanked TCW Energy for their presentation and commented that the board liked hearing some good news for a change.

18. Support for Proposed Sudan Divestiture Legislation - Resolution 2009-06

COMMISSIONER GALVIN reviewed two handouts - a recap of the benefits of the Governor's bill to restrict ARMB and Alaska Permanent Fund investments in companies doing business in Sudan compared to two other Sudan divestiture bills, and compliance procedures for following the legislation guidelines. He explained the history starting with the first divestiture bills brought forward last year. Those got a fairly negative response from the APFC and a mixed response from the Administration because of the pitfalls of social investing in general and the limited effectiveness of it as a tool for change. The bills last year also had what some considered to be significant opportunity for unintentional costs and impacts to the investment funds. An area of concern was application of the divestiture requirements to passive commingled funds, indexed funds, and investment vehicles where the APFC and ARMB did not have contractual control to manage and monitor such a policy. It could mean having to sell out of commingled funds and indexed funds, simply because the boards could not manage them properly, and not because the funds were holding investments that were a problem. That would be a significant unintentional consequence.

COMMISSIONER GALVIN said last year he testified about the Administration's support for the principle of the Sudan divestiture issue. He was clear that the Administration considered the Darfur issue to be separate and apart from the concept of social investing. Sudan is an unprecedented situation where genocide is taking place that is identified and labeled as such and called out by the United Nations, the U.S. State Department, and Congress as a place to isolate and avoid as a moral imperative. Because of the nature of that unprecedented acknowledgment, the Administration felt it could identify this as an area to implement a divestiture policy and keep it from the slippery slope into the more hot-button social investing issues.

COMMISSIONER GALVIN stated that during the interim the Governor directed the

Department of Revenue to pursue its own bill, and the Treasury Division worked on building an implementation structure that would minimize and, for the most part, avoid the costs and unintended consequences. Index funds, commingled funds, and exchange-traded funds were identified as types of investments where the ARMB and the APFC are giving authority to a manager to invest and where the state entities do not have day-to-day oversight. Other provisions of the bill are the State maintaining control over the listing of which companies would be on the "blacklist," and making sure those companies are notified and have the opportunity to respond and correct a wrong listing. The bill gives the commissioner of revenue the authority to establish a single state list that will be generated based upon information available from various sources. The Permanent Fund does not want to be independently responsible for generating a list. State Street will manage implementation. The goal is to move it away from an investment decision and make it a compliance and accounting issue. The ultimate goal is to publicly identify the companies the State is not going to do business with, and to pressure them to change, while simultaneously making sure that none of the State's money is going into those operations.

COMMISSIONER KREITZER <u>moved that the Alaska Retirement Management Board approve Resolution 2009-06, relating to support of House Bill 92 and Senate Bill 81, Sudan divestiture legislation</u>. MR. RICHARDS <u>seconded</u>.

COMMISSIONER KREITZER clarified that HB 92 and SB 81 are the Governor's bills. COMMISSIONER GALVIN added that the two other bills were brought by legislators who have indicated they are comfortable with the Governor's bill, and they will check if there is anything in their bills that they want to move over into the Governor's bill. Department of Revenue used those bills from last year as models for structuring the Governor's bill.

MS. ERCHINGER inquired if the Permanent Fund board had taken any action to support the Governor's bill. COMMISSIONER GALVIN said he intended to bring it up at the board's meeting next week.

<u>Roll call vote</u>
Ayes: Erchinger, Galvin, Kreitzer, Richards, Trivette
Nays: None

The motion passed unanimously, 5-0.

UNFINISHED BUSINESS

1. Disclosure Reports
MS. HALL indicated the financial disclosures since the last meeting were included in the packet.

2. Meeting Schedule

MS. HALL pointed out that the Education Conference date has been added to the 2009 calendar — October 26-27 in New York City. She will be working to finalize a couple of open committee meeting dates as well.

3. Legal Report

MR. JOHNSON indicated he had no formal report. He has been involved in ongoing matters at the Department of Revenue and with some of the issues discussed today.

NEW BUSINESS - None.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS - None.

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. JENNINGS said that at the last board meeting he advocated for more liability awareness, so he supported the board's move to have Callan Associates conduct an asset-liability study. He has heard anecdotes of people who were very much into the liability driven investment. That generally entails having lots of longer-term bonds or the equivalent. In some cases, those people have made so much money from being in long-term Treasuries, but as rates have come down they are pulling money off the table. That seems to be more a tactical move. The right strategic approach is to do the asset-liability study and go with that.

DR. JENNINGS offered that he was not enthusiastic about the SSgA international alpha strategy presentation earlier today. As a professor, he felt he should be particularly inclined to SSgA's statistical modeling techniques and the like. He has seen a number of them, and there is probably more the board could have heard to learn about the underlying models. He said he raised concerns about SSgA's particular model at the manager review meeting that the IAC had in the fall, and he continues to not be enthused about it. Some of his concern relates to the personnel changes on the international investment team and issues that are broader than just the presentation today.

Responding to COMMISSIONER GALVIN, MR. BADER said he was making a note about possible interaction between the IAC and State Street on that particular issue.

TRUSTEE COMMENTS

COMMISSIONER KREITZER reported that the Department of Administration did a presentation before the House Finance Committee on the basics of the retirement system and would probably do the same for the Senate Finance Committee because there are quite a few new legislators on those committees.

MR. BADER reported that the Judicial Retirement System has an allocation to private equity since the beginning of this fiscal year. This retirement fund is not at its target in private equity because there is no fund that can invest for JRS at this time. He was elated at Mr. Barnhill's presentation yesterday about creation of the common trust pool for all the retirement assets. When Ice Miller gives their decision and the full trust is in place, staff will be able to remedy the private equity underweight in JRS.

MS. ERCHINGER thanked everyone for a warm welcome to the board and said she appreciated the orientation staff gave her yesterday.

FUTURE AGENDA ITEMS - None.

ADJOURNMENT

THERE BEING NO OBJECTION AND NO FURTHER BUSINESS TO COME BEFORE THE BOARD, THE MEETING WAS ADJOURNED AT 11:20 A.M. ON FEBRUARY 13, 2009, ON A MOTION MADE BY MR. RICHARDS AND SECONDED BY COMMISSIONER GALVIN.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Gayle W. Harbo

Corporate Secretary

Note: An outside contractor tape-recorded the meeting and prepared the summary minutes. 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