State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location of Meeting
Kenakatnu Board Room
Dena'Ina Convention Center
600 W. 7th Avenue, Anchorage, Alaska

MINUTES OF
June 24-25, 2010

Thursday, June 24, 2010

CALL TO ORDER

CHAIR GAIL SCHUBERT called the meeting of the Alaska Retirement Management Board (ARMB) to order at 9:04 a.m.

ROLL CALL

Seven ARMB trustees were present at roll call to form a quorum. Commissioner Kreitzer was in attendance the second day of the meeting.

ARMB Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Kristin Erchinger
Commissioner Annette Kreitzer (June 25)
Martin Pihl
Tom Richards
Mike Williams

ARMB Board Members Absent
Commissioner Patrick Galvin
Commissioner Annette Kreitzer (June 24)

Investment Advisory Council Members Present
Dr. Williams Jennings

Consultants Present
Robert Johnson, outside legal counsel
Michael O'Leary, Callan Associates, Inc.

Department of Revenue Staff Present
Jerry Burnett, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Pamela Leary, State Comptroller
Scott Jones, Assistant State Comptroller
Zachary Hanna, State Investment Officer
Ryan Bigelow, State Investment Officer
Judy Hall, Liaison Officer

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

Invited Participants and Others Present
Michelle DeLange and Christopher Hulla, Buck Consultants, Inc.
Steve Schneider, Warburg Pincus
Marsha Roth and Tom Fuller, Angelo, Gordon & Co.
Richard Mastain and Jason Swiatek, Jennison Associates LLC
Mark Johnson and Steve Purvis, Luther King Capital Management
Leslie Thompson, Gabriel Roeder Smith & Company
Kristin Harper, Daria Foster and Todd Jacobson, Lord Abbett & Co.
Todd Rittenhouse and Ormala Krishnan, Mondrian Investment Partners Limited
Matthew Dobbs and Anthony Williams, Schroder Investment Management

PUBLIC MEETING NOTICE

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

APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda. MR. TRIVETTE seconded.
The agenda was approved as presented.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There was no one listening by telephone or attending the meeting in person who indicated a desire to address the Board.

APPROVAL OF MINUTES - April 22-23, 2010

MS. HARBO moved to approve the April 22-23, 2010 minutes. MR. TRIVETTE seconded.

MR. TRIVETTE made one grammatical correction on page 3. The minutes were unanimously approved as amended.

REPORTS

1. Chair Report

CHAIR SCHUBERT referred to the State's settlement [with Mercer] that was reported in the *Juneau Empire*, and thanked Assistant Attorney General Mike Barnhill for an excellent job. She noted that Mr. Barnhill worked closely with the Alaska Departments of Administration and Revenue, and she thanked the people in the departments for their work as well. She congratulated the Attorney General for the excellent negotiating skills he utilized to settle this matter; it was a huge victory for the retirement funds.

2. Committee Reports

2(a). Audit Committee

Committee chair MARTIN PIHL reported that the Audit Committee met June 23 to review the independent auditor's fiscal year 2010 audit plan and schedule for both the Treasury Division in the Department of Revenue and the Retirement and Benefits Division in the Department of Administration. There have been compliance developments in Treasury that should assist in the audit.

MR. PIHL said the Committee wanted to emphasize its continued concern about the need for additional employer audits by the Division of Retirement and Benefits (DR&B). The Committee heard a report from Treasury on the independent compliance audit of State Street Bank, the ARMB's custodian bank. They were also apprised about staffing, which continues to be in good order. The legal report noted the Mercer settlement, which the Board is fully informed on.

MR. PIHL stated that in the past year, at the invitation of Retirement and Benefits, Committee members participated in due diligence reviews at State Street Bank (custodian) and Great-West (the recordkeeper for the retirement plans). The Committee concluded the meeting by noting that it had covered all the areas laid out in its charter for the fiscal year.

MS. HARBO commented that she and Mr. Trivette also attended the Audit Committee meeting, and she wanted to express her concern about the [low] number of employer audits taking place. She said that, with over 250 employers in the Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS), the audits ought to be done on a more regular basis, especially the employers with a large wage base or a large number of employees. The municipalities of Anchorage, Fairbanks and Juneau are employers where an annual audit is necessary. She said she understood that some employers had not been audited for over ten years, and she was concerned, as a fiduciary, that the systems were losing out on money that should be coming in. Since the 2006 implementation of defined contribution plans, there have been a lot of changes to the retirement systems. Employers would probably welcome the audits because they also want to make sure they are doing the right things. She said the additional money that could be coming in from employers as a result of more regular audits would more than pay for additional staff in DR&B, if that was what was needed. The audit section does not have enough staff. Finally, she was concerned that defined contribution plan (DCR) employees are getting the money they are supposed to be getting in their DCR retirement accounts. She commended the Audit Committee and its chair for the work they have done and for asking great questions, but she did not think they were getting the answers they needed in a timely manner.

MR. PIHL stated that the Committee suggested that the employers actually pay for the audits. The employers are enjoying the cost share contribution rates with the State, and it is incumbent upon them to cooperate and try to make the systems work flawlessly. DR&B will be reporting back to the Committee on that request.

MR. TRIVETTE said Audit Committee member Erchinger had suggested that the actuary talk to the employers about salaries. He was uncomfortable with the actuary's salary assumption, which is doing a ballpark guesstimation about where things are at the local level. Having followed local government much of his life, he knew there were a lot of things happening at the local employer level that influence salaries. He supported considering following up on Ms. Erchinger's suggestion.

DR&B Director PATRICK SHIER said he appreciated the discussion that took place at yesterday's Audit Committee meeting. He also said he should have prepared some written reports that would have helped allay some of the fears, and, in that regard, he intended to bring a comprehensive report to the Committee at its September meeting. The division has redoubled its efforts to educate employers, not just at audits, but through places like the Alaska Association of School Business Officials (ALASBO) and the Alaska Government Finance Officers Association (AGFOA). Part of what the division does is send the retirement plan members an annual report, and they have found that these people are the best policers of accurate reporting in their accounts. Regarding the payroll issue, he had already talked to Buck Consultants, who were going to address the salary assumption in their report later in the meeting.

MS. ERCHINGER stated that the Audit Committee's due diligence visit to State Street Bank was especially helpful in understanding the issues surrounding internal controls, etc. The recent due diligence visit to Great-West included seeing the internal controls and disaster recovery system in place, but also how they take calls from plan members needing help to transfer money or with other problems. The group also learned of the volume of transactions processed by Great-West every day, and it gave her comfort to see how they do that — and maybe a little discomfort in seeing how huge their operation is. She mentioned the errors that were discovered last year and the corrections made to the affected participant accounts, noting that those errors are sometimes made by the investment houses that provide the data to Great-West to post to participant accounts. She was pleased with the controls in place at the State of Alaska and at both State Street and Great-West to catch errors: that redundancy of controls provides an extra level of confidence in the information that is transferred to plan participant accounts.

Wrapping up, MR. PIHL said that as hard as the Audit Committee has come down on employer audits, they appreciate the work that the DR&B director has done.

3. Retirement & Benefits Division Report

Deputy Commissioner RACHAEL PETRO stated that 25,604 individuals had enrolled with Equifax as of June 16 [as a result of the loss of personal information of current and former PERS and TRS members, and the subsequent settlement with PriceWaterhouseCoopers to provide protection for those members through Equifax]. DR&B handled 7,100 calls from concerned PERS and TRS members when the initial settlement terms were announced, and almost 5,000 calls since then.

Responding to MR. TRIVETTE, MS. PETRO confirmed that so far there have been no identity thefts associated with any of the lost personal information.

MR. SHIER mentioned that the regular report of PERS/TRS membership statistics for fiscal year 2010, and a summary of the Buck Consultants invoices by month and by quarter, were included in the meeting packet.

MR. SHIER reported that the division has been involved in a multi-departmental task force, convened by the Governor, to look at the impacts of the Patient Protection and Affordable Care Act [passed in March 2010] on both the active health plan and the retiree health plan. The Governor is being briefed on the information today, which is why Commissioner Kreitzer could not be at this meeting. The benefits section and the finance section of DR&B expect to spend a significant amount of time working on the health-related provisions of the new law in the coming months.

MR. SHIER stated that, although not under the auspices of the ARMB, he wanted to report that a preliminary report from the actuary indicates that the long-term care plan is just about exactly where it should be in terms of pricing and reserves. Some plan members had expressed concern that the long-term care plan had reserves above and beyond what was needed. He promised to provide the Board with a copy of the final report when it was available, so that trustees could adequately address any questions from members.

MS. HARBO raised a question that stemmed from her review of the fiscal year 2010 State CAFRs (Comprehensive Audited Financial Reports) and her conversation with Chief Financial Officer Teresa Kesey. She said there was a shortfall of $10 million in the money that went to the TRS fund from the legislative appropriation, and a shortfall of over $2 million to the PERS fund. That might not be a lot of money in the context of the overall size of those retirement funds, but it was money she wanted to see in the funds and earning interest. She had asked how to request a supplemental to get that money into the systems, and Ms. Kesey's response had been that the actuaries were going to handle it.

MR. SHIER replied that the actuary would cover that as part of their report on the difference between budgeted payroll, actual payroll, and the payroll figure that the actuary uses to estimate the amount of money that should flow into the system. He clarified that the shortfall Ms. Harbo was describing was the difference between the estimated payroll for the coming period and the State contribution calculated on that amount, and the actual payroll. If there is too much money or not enough money collected, it will be handled in the next actuarial valuation for the plans. It is not that the money should have rightly been there by estimate and the plans were shorted somehow by not enough appropriation. The actuary is undertaking an assumption review, and the Board will be able to examine that report and express its opinion on the assumptions when the report comes out later in the year.

MS. HARBO said that instead of relying on the actuary's 4% salary increase for estimated payroll, employers should be required to present a payroll estimate taken from their budget for the coming fiscal year so the State could use actual numbers. She said that Ms. Kesey had told her that while the State budgeted payroll amounts are readily available, the same information from other employers would be more difficult to obtain. In this age of technology, that [projected] wage information should be available from every single PERS and TRS employer in the state, because the State is collecting contributions based on the amount of money the employers are paying to employees.

MR. TRIVETTE stated that a lot of retirees are asking when the State is going to release information [about the impacts of the Patient Protection and Affordable Care Act]. He thought that, if the Governor was being briefed today, there should be some public information available in the next couple of days.

MS. PETRO replied that the Governor would receive an initial briefing from the task force today, but the information would be tentative at best, because new information about standards and regulations was being released every day. They would share the information once something became solid.

MR. TRIVETTE said the overview given to the Legislature around April 1 about some of the things the State was working on was a good start. It would be helpful for retirees to at least get the State's thinking on the law's potential impacts on the self-insured retiree health plan. He asked that the Department of Administration let ARMB trustees know as soon as something can be put out so they could point people to it.

MS. PETRO said they would do that. She added that they are anxious to have finality, but they are also hesitant to put out misinformation when things are literally changing daily.

MR. PIHL said the difference between the estimate and actual payroll could simply be done by a true-up once a year.

MR. SHIER expressed appreciation for the Board's attention to this matter, and that it was appropriate for the Board to comment and make decisions about how to proceed. He looked forward to a fuller discussion with the actuary later in this meeting.

4. Treasury Division Report

Deputy Commissioner JERRY BURNETT stated that the Treasury Division is fully staffed, except for one recruitment going on to fill an investment officer position.

5. Chief Investment Officer Report

Chief Investment Officer GARY BADER reviewed a list of items he wanted the Board to be aware of, as follows (and for which more detailed information was provided in the meeting packet):

- An April 30 rebalancing transaction between the PERS, TRS, and Judicial Retirement System (JRS) health plans.
- An April 30 rebalancing transaction between the PERS and TRS pension plans and the defined benefit components of the defined contribution plans.
- An April 30 rebalancing to bring the PERS, TRS, and JRS pension plan allocations closer together.
- Communication from a plan participant suggesting adding a precious metals option to the Deferred Compensation Plan fund choices. The chair of the Defined Contribution Committee has called a meeting in September at which the committee will consider several items, including staff recommendations regarding precious metals and a request to add an energy option. Dr. Jennings also will be participating in that meeting to bring his perspectives.
- A May 14 rebalancing from an overweight in domestic equities. Staff will be saying more about this type of rebalancing at a future meeting.
- Notification from Capital Guardian about changes to the international investment team there. Staff was notified of Ms. Sikorsky's intent to retire many months ago, so this was no surprise.

- A $150 million installment in the gradual transfer of fixed income assets from the Barclay's Aggregate Index mandate to the Barclay's Intermediate Treasury Index mandate. The Board approved this change [for the internally managed domestic fixed income accounts] at the February 25-26, 2010 meeting.
- An announcement of the creation of an independent investment advisor responsible for managing three Lehman Brothers Real Estate Partners funds. This matter has been ongoing for at least two years, and the Board had previously approved the team that is by and large the same team that existed prior to the Lehman Brothers' bankruptcy.
- A June 14 rebalancing among the PERS and TRS pension plans and the defined contribution plans. Staff would make a more detailed presentation on how this type of rebalancing is done later in the meeting.
- A June 14 rebalancing among the PERS, TRS and JRS pension plans to bring the asset allocations closer together.

Besides the items included in the meeting packet, MR. BADER had several other items to notify the Board of. He reported that within the last two weeks he had notified the ARM Board Chair of his intention to sign papers for an investment in a private equity partnership - Merit Mezzanine Fund. This firm makes very conservative investments in the mezzanine debt domain, and they have a strong track record of good performance. The Board had delegated to the CIO the ability to invest up to $50 million a year in private equity partnerships. Prior to making an investment, both the staff and Callan Associates must conduct due diligence in parallel. The due diligence findings are documented, and any new investment must be presented and approved by both the CIO and the Callan Manager Review Committee. Legal documentation is also sent to and approved by the Board legal counsel, Mr. Rob Johnson.

MR. BADER stated that two other managers that were approved under this program, Angelo Gordon and Warburg Pincus, would be making presentations at this meeting.

MR. BADER reported to the Board his intention to empower an ARMB real estate manager to proceed with an investment that will facilitate the higher and better use of a property.

MR. BADER said that stable value funds, which are the most popular investment options in the SBS, Deferred Compensation Plan, and the defined contribution retirement funds, could be adversely impacted by the financial reform package being debated in Congress. It has to do with the stable value managers' use of wrap contracts issued by banks or insurance companies that make it possible for stable value funds to use book value accounting. The associations that deal with stable value fund managers are doing their best to persuade Congress that this is an unintended consequence of the legislation they are contemplating. MR. BADER said he spoke to T. Rowe Price, the ARMB's stable value fund manager, about this, and they indicated it was too early to say what the outcome will be. If stable value funds were to be no longer allowed, the assets underlying the ARMB stable value funds are currently at 104% of the book value — so the funds are in very good shape at this point.

MR. BADER reported on the unfortunate news of an allegation of embezzlement by one of the investment officers at the Public Employees' Retirement Association of Colorado (PERA). The allegation is that rent checks were misused and appropriated to the private use of a person, as well as there being improper billings to the retirement system related to the management of properties. He told the Board that the investment officers in the State of Alaska's Treasury Division do not handle rent checks, nor do they issue invoices or bill people for services related to properties in the ARMB portfolio. On the rare occasion that a check is received in the Treasury Division, staff immediately forwards it to the state comptroller and her staff.

6. Fund Financial Presentation

State Comptroller PAMELA LEARY presented the financial statements for the 10-month period ended April 30. The percentage change in all the invested assets was 16.46%, and the percentage change due to investment income was 17.5%. Individually, PERS had a change in invested assets of 16.46%, TRS had a 15.75% increase, and the Judicial System was up 14.62%.

MS. LEARY pointed out the new column added to the financial statements to show the percentage change due to investment income. She noted that the percentage change in invested assets for the participant-directed retirement pension plan was 91%, while the change due to actual income was 21%, meaning contributions had a large impact there.

MS. LEARY also provided preliminary unaudited numbers for the month of May: total assets were $16.5 billion, representing a 5% decline in the month. Thus far in June the market has been relatively flat.

MS. LEARY drew attention to the one-month statements for April and said there were net withdrawals in the pension plans and health care defined benefit plans for PERS, TRS and the Judicial systems. She also reviewed information presented on graphs for the individual plans, noting that all the asset allocation targets were met, although fixed income was on the low side for the defined benefit pension plans.

MS. LEARY explained the statement showing how all the investment managers fared in the month of April, and showing the percentage increase or decrease by asset group for the month. Total domestic equity increased by 2.9%, total international equity decreased by 0.72%, and total global equity also decreased by 0.24%. Total private equity for April was up 3.91%, and the absolute return pool increased by 1.55%. Total real assets rose by 0.47%, and TIPS (treasury inflation protected securities) were notable for their 2.56% increase in April.

MS. ERCHINGER asked if the decline in total assets that Ms. Leary reported for May was investment related or a net contribution/withdrawal anomaly. MS. LEARY said she would defer to the investment professionals on that, but the market was certainly down significantly in the month. MICHAEL O'LEARY indicated that the market declined by 8% in May.

MS. ERCHINGER also inquired about the timing of the State's on-behalf contributions into the retirement systems. MS. LEARY said it occurs one time per year, and the timing differs among the plans. She recalled that it was August or September of this fiscal year for the prior year.

MR. SHIER presented the supplement to the Treasury Division financial report, prepared by the Division of Retirement & Benefits, for the 10-month period ended April 30, 2010. The Schedule of Non-Investment Changes by Fund showed a decrease of $99 million for PERS and a decrease of $78 million for TRS. The total change for all retirement funds was a decline of just over $152 million for the 10-month period. Of that, the decrease for the month of April was $65 million.

MR. SHIER addressed a question raised at the last meeting about the number of people presenting for retirement. He said the Division saw a significant spike in May, and it may have been that some people had deferred retirement for a year and then took advantage of the earliest opportunity to retire this year. That effect has essentially evaporated, and the retirement application numbers are back to traditional levels.

CHAIR SCHUBERT called a scheduled break from 9:56 a.m. until 10:07 a.m.

7. Performance Measurement - Calendar Year 2010

MICHAEL O'LEARY of Callan Associates, Inc. presented the calendar 2010 investment performance for the ARMB portfolio, noting that preliminary real estate returns were used in preparing the report. *[A copy of the Callan slide presentation and handout are on file at the ARMB office.]* He started by saying that the defined benefit plans had good absolute returns for the March quarter and for the trailing one-year period, but they were weak in a relative sense for the year (not for the quarter). The explanation is the same factors that have been discussed previously, and the lag in private equity valuations is the largest single factor.

Regarding the market in the March quarter, MR. O'LEARY said domestic equities had solid positive returns. In context, the 12-month period encompassed a market that was free-falling a year ago; the greatest percentage gains over the past year have been in sectors that did the poorest in March 2009, where there was real fear of business failure. An example was REITs (real estate investment trusts), where the REIT Index was up over 100% in a 12-month period. So it could be easy to misread the tea leaves for that particular 12-month span.

MR. O'LEARY said that credit bonds continued their strong recovery in the March quarter. The Barclays High Yield Index was up 4.6% for the quarter and 56.2% for the one-year period (so up more than the S&P 500 Index). Government bonds were actually down a touch for the year. The market went from a flight to quality to "I have to make money back." The private real estate market actually had a positive quarter for the quarter ended March. Values were still down a bit but were offset by income. On a trailing 12-month basis, the NCREIF NPI (unlevered pre-fee index) was down less than 10%. Emerging market equities did not do quite as well as REITs, but an 81%-plus return for the trailing 12 months was not something that one could extrapolate.

MR. O'LEARY stated that, against that market backdrop, the economic recovery started in the third quarter of last year and was very strong in the fourth quarter, based on the real GDP growth numbers. A lot of that strength was inventory rebuilding, and the economy moderated in the first calendar quarter of the year. The market sentiment went from a V-shaped recovery to concern about a W-shaped recovery, or the possibility of a double-dip recession. Part of the reason for the change was just wishful thinking about the strength of the recovery, but the turmoil in Europe has contributed to some hesitation. The EAFE Index was up only 0.9% for the March quarter, which was a significant underperformance of international stocks relative to domestic stocks. Almost all of that underperformance was currency related.

MR. O'LEARY briefly reviewed a periodic table of investment returns by asset class over various time periods, noting that the emerging markets index returned 10% annualized over the last ten years, while the Russell 3000 Index had a negative return for the same period. Moving on to sector performance in the U.S., he pointed out that during the March quarter consumer discretionary and industrials, which are generally thought to be very cyclically sensitive, were the strongest performing sectors. The strength in the financial sector subsequent to quarter end turned to a lot of weakness because of renewed financial concerns, and also because of the Goldman Sachs fraud allegation and the Congressional financial reform packages. On the international side, industrials and consumer discretionary were relatively strong contributors to the EAFE Index return, but information technology was the strongest sector there.

Addressing currency, MR. O'LEARY presented a graph of the EAFE Index returns for various periods over the last ten years measured in U.S. dollar terms and measured in local currency terms. He pointed out that over ten years there was not a big difference in returns between dollars and local currency. Over the long term, theoretically, the difference should be dominated by differences in inflation rates. If one economy has a higher inflation rate, over time its currency should be expected to depreciate in value. However, in the shorter term it can be a very significant differentiating factor. Over the past year the EAFE Index measured in dollar terms was actually stronger than in local currency terms, so in that particular 12-month period the dollar declined in value. It was the reverse for the March quarter, and that was really attributable to the beginning of the grief story in Europe. The reverse actually started during the fourth quarter of 2009, that is, the strengthening dollar was a negative for assets that were not denominated in dollars.

MR. BADER inquired if Callan had a position on hedging an entire portfolio, or if they were agnostic on that for currency.

MR. O'LEARY responded that having currency exposure is a positive thing because it is a source of diversification. The question is, how much currency exposure? One element is that active managers, either explicitly or implicitly, are taking currency views, and they may not be as simple to incorporate as one might envision. For example, a global company may have fully integrated operations in all major economies, and so a change in currency is less significant to that entity than it would be for its competitor who has all its production in one economic region, where that competitor would be sensitive to currency shifts with regard to its production costs. An active manager presumably is thinking about that in formulating earnings expectations for the companies they are investing in. He estimated that less than 50% of active managers actively hedge, and those tend to be managers that have lower portfolio turnover; they have a long-term view in a company, and they will defensively hedge a portion of their embedded currency position. He has recommended to two clients, who have the bulk of their international equity commitment passively managed, that they consider hedging a portion of it, if that commitment exceeds 15% or 16% of the total fund. It is recognizing that having a very heavy international exposure, simply because it is in the index, may be taking on more shorter-term risk than intended, even though it could be a wash in the long term.

MR. O'LEARY stated that many investors have moved toward parity in their asset allocation, that is, having as much international equity as domestic equity. Some investors have moved even further and are looking at the whole world and using the MSCI All Country World Index, with a weighting of 42% in the U.S., 14% in emerging markets, and the rest in developed world equities. The traditional thought for U.S. pension funds is that they pay their benefits in dollars, and, while they are comfortable with increasing their international exposure, it is nowhere near the MSCI All Country World Index diversification.

Displaying a graph of U.S. Treasury yields, MR. O'LEARY said that interest rates have increased significantly in the 12-month period ended March 31, 2010. Rates have declined subsequent to March 31, but they are still well above where they were in March 2009. Rates have declined because of another flight to quality. He also explained a chart of Barclays Capital fixed income index returns: the Aggregate was 1.78% for the March quarter, but the big gainer was the CMBS Index (commercial mortgage-backed securities), with a very attractive 9% absolute return. The 12-month period was a marvelous period for investors in credit instruments, but the world is clearly different now.

Turning to a graph of real estate as measured by the NCREIF Index, MR. O'LEARY pointed out that the most recent level of [commercial real estate] transactions has been very low, but it seems to be trending toward more activity. He said there has been an incredible change in attitude and activity in the institutional real estate market. In the fourth quarter of 2009, it was not uncommon to see large open-end funds have a queue of a billion dollars or more to get out. Some of those same funds today have a queue of a billion dollars or more to get into the funds. It is not because there is a tremendous amount of activity in real estate investments. In the midst of the meltdown, a concern of all major institutional investors was that they knew where stocks and bonds had been marked to, but real estate was not being marked down as quickly as publicly traded instruments. So their asset allocation looked like they were woefully over-allocated to an asset class that was going to tank. (There was a similar reaction in private equity.) There was not a lot that institutional investors could do about it, but they set in motion some activities, such as redemption requests to open-end real estate funds. That has reversed for two reasons: stocks recovered significantly, so the denominator effect that created the apparent over-allocation is less significant; and the real estate values have been adjusted down. Unfortunately, some real estate programs employ a lot of debt, so it is not just a change in value; it is a real change in economic circumstance — and that becomes property and strategy specific. There are untold instances of people, even in commercial investments, mailing in the keys; so that is a real loss.

The NCREIF Property Index return over the last ten years was positive 7.12%. The Russell 3000 Index over the same ten-year period was a negative return. The NAREIT Index for public real estate returned 106% over the past 12 months, and the ten-year return was 11%.

Using PERS as the proxy, MR. O'LEARY said actual asset allocation was close to target, with equity being generally over-allocated and fixed income being generally under-allocated at March 31. He added that, unfortunately, the market had probably taken care of much of that already.

Compared to other public funds in the Callan public fund database, the Alaska retirement fund has a relatively heavy weighting in international equities, a heavy allocation to real assets, and a comparatively low allocation to fixed income. He reminded everyone that Callan's data is based on how individual clients characterize their assets.

MR. O'LEARY reviewed the attribution effects in the PERS performance for the March quarter, for the trailing year, and for longer periods. The return for the quarter was

3.24% compared to the target index return of 2.99%. On balance, the managers added a little value. For the trailing 12 months the fund had an attractive 26.77% return, but it was poor relative to the target index return of 33.41%. The fund's real estate was down 14.5% in the period, while the NCREIF Index was down 0.76% — so that was a significant effect. The preliminary real estate numbers for the March quarter show a positive return of 1.17%, so all the damage for the trailing 12-month period occurred in the preceding nine months. Also, the retirement fund's private equity earned 2.84% for the trailing year, but the target index for domestic public equity was up over 52% in that period. That was a negative contributor to total return. However, private equity still makes sense, because the annualized return over the seven-year period was over 12%. And looked at over five years, private equity was the best performing asset category.

MR. O'LEARY said that over the long term the retirement fund results have closely tracked the target index returns — 7.41% versus 7.47% over 18-1/2 years. There are always going to be timing differences in recognizing returns, particularly when the fund has meaningful exposure to private markets.

MR. O'LEARY mentioned a paper that Callan recently put out that analyzed the actuarial return assumptions for public pension systems, and he encouraged trustees to read it.

MR. O'LEARY next reviewed the retirement fund performance by asset category, as follows:

- Total bond performance (including international bonds, emerging market debt, high yield debt, and the internally managed portfolio) was very competitive compared to other public funds over the March quarter, the fiscal year, and for the two-year period. Public funds with the best bond performance over the past year had a very heavy high yield exposure.
- The internally managed bond portfolio was comfortably above the market benchmark. The composition of that portfolio is changing radically and becoming a Treasury-oriented portfolio. In the future, Callan will come up with another peer group against which to measure its performance.
- The aggregate large cap equity portfolio was up over 48% for the trailing 12 months, compared to the S&P 500 Index return at just under 50%. Barrow Hanley and QMA, the two newest large cap managers had strong full year results. Both managers have a value orientation. McKinley Capital, which has a growth style, had a good March quarter, but the trailing one-year return remains weak. Relational's performance has been quite strong for the last two quarters, but it continues to be weak longer term.
- The aggregate small cap equity portfolio had good performance in the quarter and on a fiscal-year-to-date basis, and was a tad below median over the trailing 12 months. Jennison had a very good year, and their longer-term record is good. Lord Abbett had a strong quarter, was below the benchmark for the year, and

has a very competitive longer-term result. Luther King also had a strong quarter but has more mediocre results on a since-inception basis.

- The total international equity portfolio has attractive performance for all cumulative periods when compared to other funds. For a long time, that has been driven largely by the ARMB's meaningful emerging markets exposure.
- The record of the developed international managers is better than the benchmark but less appealing than the total international performance. McKinley Capital had a weak quarter. Brandes has strong longer-term results but had weak recent returns. Capital Guardian was below the benchmark for the trailing one-year period but is ahead for longer periods.
- The three emerging markets managers, collectively, lagged the benchmark for the trailing year, but the results were so strong in absolute terms (80%) that they really drove the total fund performance. The emerging markets pool was up over 4% for the March quarter, while the benchmark return was 2.45%.
- Lazard's global equity portfolio did not have a particularly great calendar year. However, their performance has been comfortably above the benchmark over the three- and five-year periods. Lazard has a fairly consistent record of adding a little value in weaker market environments and not shooting out the lights in strong market environments.
- Mondrian Investment Partners has managed the international bond portfolio for a long time. While the March quarter was negative for them, they did a fine job relative to other international fixed income portfolios and relative to the index. Mondrian's long-term record continues to be great.
- The internally managed REIT portfolio had a strong absolute quarter (9.3%) and trailing one year (101.9%), although both were behind the NAREIT Equity Index.
- The composite of the hedge funds met its return objective of LIBOR + 5% for the quarter, the fiscal year, and for the trailing one year. The portfolio still has ground to make on the longer time periods.
- The high yield bond composite lagged the benchmark for the quarter and trailing 12 months. Both high yield managers, Rogge and MacKay Shields, have a higher quality orientation than the benchmark, so it was not surprising that they underperformed. Of the two, MacKay Shields has clearly done a better job than Rogge.

MS. HARBO asked why Rogge was not on the manager watch list, when they have not done very well over almost five years. MR. O'LEARY said Rogge was on his watch list.

MR. BADER stated that the whole watch list process needed to be re-evaluated. It was put in place by the previous board, and the focus was primarily on equity managers. While high yield bonds are very similar to equity, the range of returns tends to be more compressed than for equity managers. It is possible for a high yield manager to consistently underperform but not be in the bottom third of the peer group, which is one of the watch list criteria. Mr. Bigelow and his staff are working on historic returns for high yield and will be presenting that, along with a recommended appropriate benchmark, to the Board at the next meeting. The Board will have an opportunity to consider Rogge and MacKay Shields at that time.

MR. O'LEARY said he would be much briefer than he would like in his comments on the individual account plans. Regarding the stable value options in the Supplemental Benefit System (SBS) and the Deferred Compensation Plan, the proposed swap restrictions that have been part of the federal financial reform discussions would affect the availability of wrappers, which is a real issue. Even if there were no change in regulations, the availability of wrappers is a real issue. Some of the biggest issuers of wrappers have withdrawn from the market or significantly reduced their capacity. Presuming that wrappers will continue to exist, stable value managers, such as T. Rowe Price, may seek to change their investment guidelines. They may move toward building a portfolio of investments in guaranteed investment contract (GIC) types of instruments. Nobody knows better than Alaska what the potential risks are associated with such investments.

MR. O'LEARY said he thought the underlying portfolios [of stable value funds] would become even shorter in duration than they are presently. He has had conversations with four of the top five stable value managers to get their sense of what the environment is like and how the industry will react to potential regulatory changes. The Board may want to allocate some time to this topic in the not-too-distant future. The news that State Street was closing down its stable value product was significant.

MR. O'LEARY said that, fortunately, the ARMB has one of the best stable value managers in the business in T. Rowe Price. The stable value fund in SBS is $270 million, and in the Deferred Compensation Plan the stable value fund totals about $158 million. The performance in both areas has been very strong.

As part of his series of highlighting certain segments of the various participant-directed programs each quarter, MR. O'LEARY explained how Callan has developed comparative universes for contrasting the different target maturity vehicles available in the State of Alaska's SBS plan. He said the most important thing in considering target date performance is whether the manager generated returns that were in line with the agreed-upon target date index. But it is also interesting to look at a relative performance comparison because the participants are routinely aware of how XYZ target date funds performed. The XYZ target date funds may have a different glide path than the Alaska target date funds, so the results may look great or poor relative to XYZ, depending on how different the glide paths are.

MR. O'LEARY stated that, in the target date fund industry, T. Rowe Price tends to have a little more of an equity orientation. That clearly worked well for their fund returns in the economic recovery market.

MR. BADER mentioned that there has been a lot of news devoted to target date funds to the effect that there might be something wrong with these funds, although the references were about funds at the extreme. He asked Mr. O'Leary if he had any comment on that.

MR. O'LEARY said that individual participants always want to do a little bit better, and so there is a tendency to chase performance. The industry feeds that chase by offering even more aggressive products when aggression has been compensated, and more conservative products when aggression has been counter-productive. At the moment, a great debate is ongoing about whether the glide path should be to retirement or through retirement. Some fund companies are now offering target date funds that have cash at the target date, but that is where the State of Alaska was a decade ago. At that time, looking back over the preceding 10 or 20 years, the more equity in a target date fund portfolio, the better off the participants were. What has changed? Today, looking back over the preceding ten years, the more equity in a target date portfolio, the poorer the participants' return. The purpose of this money is to fund retirement, and there is recognition that a market event can have a substantial effect. People are dealing with it in different ways. Some people are saying that the investment risk is being borne by the participants — it is a substantial risk — and asking if there is some way to moderate it without reducing their ultimate benefit. It is the last part that is getting triggered. The Board will be hearing about annuities at an educational session, because participants are saying they really like the idea of having a dependable check they can count on in retirement, and they are asking if there is another way to do that.

MR. PIHL asked if Mr. O'Leary had any further comment on the performance of McKinley Capital's international portfolio.

CHAIR SCHUBERT inquired if there were any managers or anything else the Board should be concerned about.

MR. O'LEARY stated that McKinley's style is very volatile, and it is important to look at returns for cumulative periods, other than just the March quarter, because their international product has looked very good for spans. They have been at the top of the heap and then been very poor, and the March quarter caught them at one of the poor moments that has affected the performance of all the cumulative periods. The weak performance is certainly cause for concern, and it is essential that it improve. McKinley had a similar pattern in the domestic equity portfolio, and there has been some recent relative improvement there. He said the proposed revision to the manager watch list would probably put McKinley on the list because the performance is relatively poor.

Responding to the chair's question, MR. O'LEARY said that Relational's performance has improved, but the fundamental issue is that the large cap equity portfolio is very concentrated. The question is whether that type of approach is the most appropriate for the ARMB's investment program. He said that, aside from that, the Board has done a good job of pruning out managers.

8. Warburg Pincus - Private Equity

MR. BADER stated that the Board gave staff the authority to hire some managers, and he thought it appropriate that some of the private equity managers that were hired speak to the Board about the progress they have made to date. The ARMB committed $30 million directly to the Warburg Pincus X fund in September 2007, but the ARMB has invested with Warburg since 1998 through its fund-of-fund manager, Abbott Capital. He introduced STEVE SCHNEIDER, a partner at Warburg Pincus and one of the senior partners on the executive management group, to give the presentation.

[A copy of the Warburg Pincus slide presentation is on file at the ARMB office.]

MR. SCHNEIDER started by saying that the firm feels confident about the performance of the fund that the ARMB invested in directly, as well as the funds it has invested in indirectly. Despite the turmoil and challenges on the outside, Warburg has a long-term focus and has made nice progress in the last year and a half or so. Warburg Pincus pursues a differentiated strategy, so, within the context of one fairly large private equity fund, they do everything from raw venture capital company start-ups to growth investing — where there is little or no leverage, to late stage companies - public or private. They do that in five major industry categories and on a number of continents in the world. A typical Warburg Pincus fund has 60 to 80 portfolio companies, from small commitments to large commitments. To their knowledge, there is no one else in the private equity industry pursuing that strategy in the context of one large fund.

MR. SCHNEIDER said the net returns have been 27% for the last 15 years and 21% over the last 20 years. Warburg Pincus has consistently been in the top quartile of returns. In terms of multiples of money, they consistently approach the top decile of performers. That means that when someone gives them a dollar, they try to turn it into three dollars, instead of returning two dollars more quickly. The style of longer average holding periods and higher money multiples fits their growth characteristics.

While Warburg Pincus has managed 3% of the U.S. private equity industry's money over the last 10 to 20 years, they have sent back about 7% of the industry's proceeds in distributions to the limited partners. That can only be done over extended time periods if the funds have higher money multiples. The number of companies owned in a fund and the eclectic nature of the stage-of-life industry and geography mean they always have something that somebody wants to buy.

MR. SCHNEIDER stated that Warburg Pincus is managed as an institutional firm and does not think of itself as a collection of people doing deals. The firm completed a generational change from its founders to folks of his generation ten years ago. In any industry where there are private partnerships involved, it is a non-trivial thing to go from one generation to the next, and they are pleased that it was successful and is in the rearview mirror. Regarding alignment of interests, Warburg Pincus is the largest private equity firm in the world that does not take deal fees, financing fees, monitoring fees, or maintenance fees. They only make money when their limited partners make money. They happily say no to several hundred million dollars a year because they are essentially a growth investor and do not believe in making money from deal fees.

MR. SCHNEIDER explained the firm's growth orientation, with the majority of the capital invested in the growth capital category, which is a four-to-five- times-your-money proposition. It has low leverage, and if it does not go well, you could expect some loss of principal, but hopefully not a full loss of principal. They are still in the business of venture capital investing, where, if all goes well, you can make ten times your money or more. On the other hand, you could lose it all. They do [venture capital investing] in very small amounts in any one transaction. Special situations and leverage buyout investing are a small part of what they do. That kind of investing yields 2-1/2 to maybe three times your money where you hope not to lose any principal. In every fund that Warburg Pincus has had, up to 70% of the money has been in the growth capital category combined with venture capital. The breakdown in how they earn profits for their limited partners is roughly 80% from growing companies' earnings, about 10% from using leverage, and about 10% because the multiple when they get out of a deal is higher than what they invested at.

MR. SCHNEIDER stated that for 30 years Warburg Pincus has specialized in five core industry sectors. Other firms think about how few partners they can have, but Warburg Pincus is happy to have 60 partners and to divide up the profits 60 ways. By specializing by industry and by geography, they believe they have a better chance of attracting the best management teams in the world. Also, they have learned a lot from industry cycles. For example, in 2000-2001, technology was the future, every tech deal went to the moon, and some firms fired their health care people. Their view is that health care is a fundamental part of the economy that is not going away. Health care's attractiveness may ebb and flow, but they take a very long-term view and believe it will not cease to exist.

Warburg Pincus is global and has been investing in China and India for 15 years. Their offices there are staffed with all local nationals. India and China, over an extended period of time, are roughly 10% each of what Warburg Pincus does. They have been investing in emerging markets long enough to have moved from the excitement phase to the real promise phase to the you-made-money-on-paper phase to the returning-money-back-to-people phase. They have returned more money in the emerging markets area than they have drawn down, and the returns are in the twenties and more than two times multiple.

MR. SCHNEIDER next addressed performance. Warburg Pincus has outperformed the S&P 500 Index by between 11% and 18% over any time period, counting dividends thrown back in. They have outperformed other private equity firms by 600 to 1,500 basis points, depending on the time period, putting them in the top quartile. He showed a list of signature transactions that Warburg Pincus has been associated with over the years, noting that it is a very eclectic and diverse list.

MR. SCHNEIDER spent some time reviewing the Warburg Pincus X fund that first closed in October 2007. It is a $15 billion fund that has drawn about 52%-53% of its capital. As of March 31, the fund has 38 portfolio companies and 1.6 years of average life. That last number is about one-quarter of what it needs to be for Warburg Pincus to tell what it is really going to turn into. The fund at one point was as low as 60 cents on the dollar, but it has clawed its way back. When the June quarter is complete, it looks entirely probable that the net rate of return will improve and the fund multiple may approach 90 or even 95 cents on the dollar, erasing some of what the world and this fund went through. Despite the vintage exposure to 2007 and the early part of 2008, the fund is tracking quite well. In particular, things they did in 2008 and 2009 were well timed and have had a nice rebound already. About half the fund remains undrawn.

MR. SCHNEIDER explained that Warburg Pincus told ARMB staff that they thought Fund X could generate funds that would provide a 20% net return and a three times money multiple. That would be if the market winds were normal. If the winds were blowing in their face, they generally expect to be getting around a 15% net rate of return and maybe a 2-1/2 times gross multiple. Clearly, the winds have been in the face of the markets since Fund X began. Right now, they think Fund X will have a return in the teens, between where they originally expected and the wind-in-the-face scenario. He said he was not talking about a profitable second half of the fund investing, but just the money in the ground when it goes full cycle. While the return will not be 20%, a high teens performance would clearly outperform the public markets.

MR. SCHNEIDER briefly reviewed some investments in Warburg Pincus Fund X that include MBIA, Primerica, a Canadian oil sands company, some later stage investments like Bausch & Lomb, a bunch of smaller and early stage companies like Coyote Logistics that have real large potential, and growth-oriented investments in China.

MR. SCHNEIDER stated that ARMB staff had asked him to also provide a perspective on several topics, including emerging markets, developed markets, venture capital, late stage investing, and the state of debt and equity capital markets.

He said Warburg Pincus likes emerging markets, but they do not pre-ordain how much they will invest in them. Every deal has to pass the test that, adjusted for its risk/return, it makes sense. The people the firm has in China and India do not make money on their own deals; they make money on how the whole firm performs. So if they like the risk/return of a deal, they invest; if they do not, they sit on their hands. However, Warburg Pincus sees an extraordinary amount of potential in China. While it is volatile, it helps that the firm has been there for 15 years. They cannot do leveraged buyouts there, so it is a market for late stage venture and growth investing, which is perfect for them. A number of companies have massively outperformed what was expected, one of which was the first private equity company to go public on the ChiNext Exchange, China's NASDAQ-style board. Warburg Pincus is quite pleased with the growth trajectory in India, which is roughly 10% of what the firm does. They have six of the ten largest capital gains in private equity in India, which one might not expect of a non-Indian firm. This market has a bit more competition from other private equity firms, but the real competition is the public markets, and, to a certain extent, debt markets. Warburg Pincus has opened an office in Brazil with two partners there. They have looked at two deals but have not invested in anything yet.

In terms of developed markets, MR. SCHNEIDER said that some in the industry talk about the rebound that is going to happen or has happened in the U.S. and that will eventually take place in Europe. So against that rebound, maybe everything one buys does well, but Warburg Pincus has been doing this too long to subscribe to that view. They still believe it is a company-picking environment where they have to pick quite well to produce the kinds of returns they expect. So they are happy to sort through dozens, if not hundreds, of companies before they find one they like. They do not believe in the rebound-takes-care-of-all theory.

MR. SCHNEIDER stated that some of the limited partners they have are losing patience with venture capital. For the last ten years, all one had to do to be in the top quartile in this subsegment of the industry was to not lose money. That is not what Warburg Pincus is looking for. They define venture capital as anything that could be a startup, such as ultra deep drilling off Ghana or the first dollars in the Canadian oil sands. Their venture investing over the last decade has been about a 20% return business, instead of zero. That is because they focus on creating free cash flow companies that can fund themselves, not gee-whiz technology companies. The simple view is that the world has too much technology but not enough talented management teams to apply that technology.

Regarding debt and equity capital markets, MR. SCHNEIDER said the credit markets are extremely volatile. There was a moment in the last couple of quarters where it seemed like everything was happy again, if not a little silly. Given what has happened in Europe recently, the horns have been pulled in, and the debt markets are not nearly as available as they were on attractive terms. Warburg Pincus believes the equity markets are actually leading the high yield markets. The high yield markets are actually leading the bank markets, because the bank markets do not have a lot of bank capacity. Not many banks want to make loans. The only real bank-like issuance are instruments called CLOs (collateralized loan obligations), and the only way they get freed up is if a yield bond finances them. So the debt financing that was available a couple of quarters ago proved to be very small windows that opened and shut quickly. The situation is not as bad as it was in 2008, but it certainly is not as good as it was in 2005.

MR. SCHNEIDER stated that IPO markets around the world are fairly treacherous. Warburg Pincus has five or six companies go public a year, on average. The market is looking for growth, an element of defense, and they want it cheap. If one can find all three of those things in a company, it will be quite dear. Against that backdrop, and since Warburg Pincus has relatively unlevered growth companies, they are happy to take some companies out and begin the process of monetizing by taking things public.

MR. O'LEARY asked for Mr. Schneider's comment on the significance of tax changes affecting the domestic private equity business.

MR. SCHNEIDER replied that the industry has a very good business model, and private equity managers ought to get management fees that cover the overhead, plus they have a chance to make good money if the equity grows in value. Warburg Pincus's view is that whatever happens in Washington tax-wise does not change anything fundamentally about how they run their business. Others are quite focused on building asset management companies, but Warburg Pincus does not want to do that. Others are focused on taking their company public and monetizing big streams of fees, but Warburg Pincus does not want to do that. They have talked to people in Washington, but if they do their job right they should be fine. There are other tax issues [besides the proposed change to tax at capital gains rates what is now taxed as ordinary income.] For example, there was an article today talking about some non-U.S. and emerging markets thinking about beginning to tax what were previously non-taxable transactions when a capital gain is generated. Being in the emerging markets as long as they have, Warburg Pincus is paying a lot of attention to that issue. When they price transactions in emerging markets, they include whether there will be a tax issue someday as one of the risks.

MR. TRIVETTE asked if any companies in Fund X had failed since it began in 2007. MR. SCHNEIDER said not if failure was defined as a company that is completely gone and that earned nothing. However, they had one late stage company where they had to decide whether to put in more money at the darkest moment, and they took the pain instead. The investment was radically written down and, while the company still has a small carrying value, they do not expect it to come back.

MR. TRIVETTE asked if Warburg Pincus expected any company failures over the next two years. MR. SCHNEIDER explained that because what they do is growth-oriented, they are not on the edge of the ledge in terms of leverage. Of the 115 companies that Warburg has, including some of the older funds, none have covenant issues of any materiality, and there are probably less than a handful of companies that would have more than six times leverage. Of firms and funds the size of Warburg, there is almost nobody with a hand of cards that is that good. They are more reliant on growth and on talented management teams than they are on the debt capital markets. It is why they were more active in 2008 and 2009 than the LBO-only firms; Warburg Pincus sent back $1.5 billion to its investors in each of the last two years.

CHAIR SCHUBERT thanked Mr. Schneider for his presentation before recessing the meeting for lunch at 11:50 a.m. She reconvened the meeting at 1:00 p.m.

9. Angelo, Gordon & Co. - Private Equity

Following Mr. Bader's introduction, MARSHA ROTH and TOM FULLER of Angelo Gordon gave a report on the $25 million that the ARMB invested in Angelo Gordon Capital Recovery Partners VI in January of 2008.

MS. ROTH provided an overview of the firm and said they would focus the presentation on the distressed debt strategy. Last year, they Angelo Gordon added 30 people in the infrastructure side to bring the total number of employees at the firm to about 200. She said Mr. Fuller was the portfolio manager for distressed debt and had been the head of the 22-member team for the last five years. He has 20 years' experience in the business, ten of those at Angelo Gordon.

[A copy of the Angelo Gordon slide presentation is on file at the ARMB office.]

MR. FULLER stated that a key component of their strategy, and how they differentiate themselves, is by being very actively involved in the restructuring process. They have very senior people who can lead the negotiations in a room of multiple parties with opposing views. Among the different distressed debt strategies, Angelo Gordon targets corporate distressed debt — large corporations, primarily based in North America, that generally have taken on too much debt and simply cannot pay it back. Angelo Gordon tends to be one of the largest creditors in each of the situations they get involved in.

MR. FULLER explained the range of distressed debt investing, from trading strategies - or more of a hedge fund approach, where people are buying and then selling short something against that, to the opposite end where investors buy debt, convert that debt into an ownership position in the company, turn the operation around in three to five years, and then sell it to someone else. He said that Angelo Gordon operates in the middle of that spectrum. Their portfolios of about 45 investments are much more diversified. Fund VI has 47 investments, and the positions are sized to diversify the risk. A large position would be 5% of the committed capital. Their goal is to have no more than 1% of the ARMB's money at risk in any given instrument in the portfolio. If their analysis indicates that in a down side case they could lose 20% of the money, that would be an investment where they would be willing to risk 5% of the capital. So, if they were wrong, they would lose 20% of the 5% of 1% of the capital.

MR. FULLER stated that Angelo Gordon tends to be senior in the capital structure, that is, owning loans or bonds that are secured by the assets of the business. So, if they are wrong, it is very unlikely that they will lose all the money, because there are assets backing the money they invested in the company. What they do is very similar to value investing, that is, they value the business backing the loan, and try to buy at a discount to that. That may be 70 cents on the dollar. The difference in doing that from being a value equity manager is that the equity manager is basically hoping that another person believes it is undervalued and starts buying it. When you buy debt instruments, you have a lot more rights than an equity owner has. The debt comes due on a certain date, but in the meantime the company has to pay you interest, and there are certain covenants they have to meet. Angelo Gordon targets situations where they think the company is going to violate a covenant, where a company is going to miss an interest payment or be unable to pay the debt when it comes due, which will allow a negotiation to begin. Being one of the biggest creditors in those situations gives them a big voice in the outcome of the restructurings, and so they will be active on creditors' committees.

MR. FULLER said that one of the largest investments in Fund VI today is in Tribune, where Angelo Gordon is one of the three largest creditors and is actively negotiating with the management to basically reduce the debt from $9.0 billion down to $1.0 billion and convert a portion of it to equity. It is a very hands-on investment process. Angelo Gordon is well known to the bankruptcy lawyers, to the workout officers at the major banks, to the counterparties that they buy product from — such as JP Morgan and the investment banks, and to the industry leaders. Angelo Gordon's reputation is one of trying to get transactions done.

MR. FULLER spent a few minutes reviewing how the $2.0 billion Fund VI is constructed. The fund is 100% invested, and its investment period goes to June 30, 2011. Angelo Gordon keeps all the capital invested, reinvesting any proceeds. The average holding period is about 14 months, so they attempt to invest the capital two to 2-1/2 times during the three-year investment period. At the end of the investment period, the portfolio tends to turn to cash fairly quickly and get returned to investors. The ARMB has invested in a seven-year fund, but in reality it is going to be about a 4-1/2 to five-year investment period. Distressed portfolios tend to have big concentrations because a lot of companies in the same industry will get into trouble for macro reasons.

About 24% of Fund VI is in media. In the third and fourth quarters of 2008 U.S. corporations pretty much put the brakes on advertizing spending. Those businesses tend to have a big component of fixed costs, so when they lost a dollar of revenue they lost a dollar of cash flow. Multiples collapsed, valuations collapsed, and the price of the senior secure debt of those companies also collapsed. By playing at the top of the capital structure, Angelo Gordon did not have to be precise as to when the U.S.

corporations were going to start spending ad dollars again. They have begun to sell down the media portion of Fund VI because in the fourth quarter of 2009 and into 2010 companies began to spend again on ad dollars. So valuations are going back up and multiples are expanding, and they are monetizing those positions. They expect the 3% sliver of the portfolio that is real estate to get a bit bigger, and just last Friday they established a large position in the Hilton Hotels, an operating company that manages 3,000 properties.

MR. FULLER mentioned that Fund VI is 96% North American. The only place they invest outside of North America is basically the U.K., which has tried-and-true insolvency rules. Angelo Gordon expects to see the Western Europe piece of the portfolio get bigger, as they see a lot of opportunities there. Ninety-five percent of the portfolio is in the top of the capital structure, so if things go wrong, they will be the first to get paid back.

At March 31, 2010, the ARMB's $25 million investment was worth about $30 million. During the last nine months of 2008 and the first quarter of 2009, Angelo Gordon was slowly investing more money as prices fell. Now the ARMB's portfolio is up about 12%, and the target is to make 15% to 20%. There is no leverage in the portfolio, so that target is an unlevered 15% to 20%. They are getting close, although the last few weeks were a little more difficult when people were frightened by things in Europe.

Turning to what Angelo Gordon expects between now and June 30, 2011, MR. FULLER said it is always a big debate in the distressed debt business. People who thought things were bad in January of 2009 and that Angelo Gordon should not invest any more of their money, a year later were saying that [the economy] had gotten better and the opportunity to invest had passed. He said he thought those people were wrong in 2009 and they are wrong today. Angelo Gordon believes there will continue to be good opportunities for the remainder of the life of Fund VI. They have also raised a successor fund, Fund VII, and they will be investing that through 2013. They believe there will continue to be good opportunities for an extended period of time. Looking at the data, there is a little less than a trillion dollars' worth of debt coming due in the junk bond market and the junk loan market between now and 2014. The reality is that it is going to be very difficult for companies to refinance that. About a third will be healthy companies that are able to hit the junk bond market and refinance the bank loans. A third are going to be companies because the bank loan market, which is about two-thirds of this amount that is coming due, is completely closed *[sentence is verbatim]*. Another third that cannot hit the bond market — because the bond market would have to grow 50% to refinance all this debt — will negotiate with firms like Angelo Gordon, which will extend the loans for a longer period in return for increased pricing and will make money. Then a chunk of that trillion dollars will ultimately have to do a formal restructuring.

MR. FULLER said that companies that normally would have been refinancing in the market in 2007, 2008 and the beginning of 2009 were shut out of the market because the market was closed. Now there is a compression of that: banks are not lending structured products, which were about two-thirds of the loan market. That is going to continue to create challenges.

MR. FULLER stated that Angelo Gordon does not have any macro views or opinions on where the economy is going. Their view, generally, is that things are not getting any worse but probably are not going to go back to where they were in 2005, 2006, and the beginning 2007. An environment where corporate earnings are down significantly, or flat, or up slightly, and where there is a tremendous amount of debt coming due, presents opportunities for the firm.

MR. TRIVETTE asked if any of the companies in which Angelo Gordon holds an interest have defaulted or closed up shop since 2008. MR. FULLER mentioned Lehman Brothers, and added that Angelo Gordon tries to target good companies with too much debt, where they can reduce the debt and put the companies back on smooth sailing.

MR. O'LEARY had a question about [the significance of proposed tax changes], in particular pertaining carried interest. MR. FULLER stated that Angelo Gordon had been expecting something [like the financial reform being proposed], and it was not going to impact them as a firm, other than the firm will make less money.

MR. O'LEARY asked if Angelo Gordon would use [any tax changes] as justification for trying to change the economics of the private equity fund investments. MR. FULLER said no, that their carried interest is a little different than perhaps some of the traditional private equity firms. Angelo Gordon does not pay out the carried interest on individual deals prior to everyone getting their invested capital and preferred return back. They operate the business based on making the 20% returns and, if they do that, everyone will do well. Any tax changes will not impact them to sell something sooner, before the tax laws come into effect.

CHAIR SCHUBERT thanked the Angelo Gordon people for their presentation.

10. Jennison Associates LLC - Small Cap Equity

MR. BADER introduced JASON SWIATEK and RICHARD MASTAIN of Jennison Associates to make a presentation on the small cap equity portfolio the firm manages for the Alaska retirement fund. *[A copy of the Jennison Associates presentation slides is on file at the ARMB office.]*

MR. MASTAIN, the client service representative, mentioned that they were last before the Board in December 2008, at a time when the economy and the markets around the world were in the worst shape that people had seen in many decades. At that time, Jennison had responded to a question from Mr. O'Leary and said that the firm would have no layoffs. Today, they have 255 employees, and at the end of 2002 (the end of the last bear market) they had 240 — so essentially the same number. The firm's assets are about twice what they were. They have managed to come through a difficult period in very good shape and with no layoffs. That is important because it allows their investment professionals to keep their eye on the ball, morale remains high, and people know that they can do their job. That leads to the second important point, which is that the firm has been able to deliver performance for their clients. All of Jennison's equity strategies outperformed their benchmarks in 2009.

MR. MASTAIN stated that Jennison Associates has been managing a small cap core mandate for the ARMB for just over five years. Five years ago, no one would have guessed the tremendous market turmoil and volatility that has taken place. However, Jennison is pleased to report that the performance of the ARMB portfolio has been consistently above the benchmark over that period.

MR. MASTAIN reviewed some information about the firm, noting that of the $99 billion in total assets under management approximately $2.0 billion is managed in each of the small cap and small/mid cap equity categories.

Portfolio manager JASON SWIATEK reported that the small cap portfolio returned 35% in 2009, compared to the benchmark Russell 2000 Index return of 27%. To date, 2010 has been a strong year, with the portfolio up about 60 basis points above the benchmark. The Russell 2000 has been in positive territory so far this year, while the S&P 500 Index has been negative.

MR. SWIATEK displayed a slide of the longer-term performance for the composite small cap core portfolio going back to its inception in April 1998. He said they have outperformed the benchmark by 200 to 300 basis points over that time period. They are pleased with not only the absolute return over time but also with the consistency of that performance. He described an analysis they did to determine that the composite portfolio outperformed the benchmark on a quarterly basis roughly 60% of the time over almost 12 years. It speaks to an investment team and a process built over the years that has been tested and that works.

MR. SWIATEK reviewed the seven-member investment team for the small cap product, drawing attention to the average 15 years of experience of the investment professionals that is unique in small cap space. He said this was the strongest team that Jennison has had working on the small cap product.

MR. SWIATEK next discussed the current portfolio characteristics. The combination of stronger growth than the benchmark and a valuation that is superior to the benchmark is a fallout from their two-step process. The first step is to identify high quality, small cap businesses that they believe can grow between 10% and 25% on a sustainable basis.

The second step of the process is their discipline on valuation. They often follow companies for years, listening to quarterly earnings calls and visiting companies both in New York and at their headquarters. They then take advantage of the volatility that can occur in small cap space, such as when a company has a temporary hiccough or when small cap stocks are out of favor, and invest in the list of superior, high-growth businesses they identified in the first step. The superior earnings growth serves the portfolio well in growth markets, and the valuation discipline serves it well in value markets and down markets.

MR. SWIATEK reviewed the portfolio sector allocation. He said an historical attribution analysis of the portfolio would show that about 80% of the outperformance comes from bottom-up stock selection. They are very balanced across sectors, but they do take modest industry overweights and underweights. The only notable underweight currently is consumer discretionary, where they believe there is a lot of pressure on consumers because of high unemployment, high energy prices, and a housing market that still has not recovered. Jennison believes that it is more difficult for companies in the small cap space that specialize in the consumer area to prosper in that type of economic environment. The portfolio is currently overweight in consumer staples, such as grocery stores and food product companies.

The largest equity holdings in the portfolio are in the 2.0% to 2.2% range, and that scales down to the 1.0% range for the 20th largest holding. They believe that not taking large bets in terms of individual holdings provides the optimal level of diversification for clients but also affords the opportunity to add that 200 to 300 basis points of outperformance they have delivered over the portfolio's history.

MR. SWIATEK reported that year to date Jennison has had very strong stock selection in health care and consumer staples. Health care has been a volatile sector because of how federal health care reform will impact various industries. But they have navigated the turmoil very well, and health care has been a significant source of outperformance year to date. Small cap stocks generally have performed well this year, although 70% to 80% of small cap managers are currently trailing the benchmark. Jennison is ahead of the benchmark so far this year.

Turning to the portfolio outlook, MR. SWIATEK stated that Jennison is in the camp that sees signs of sluggish economic growth, and, unfortunately, that might be the environment they have to deal with for a while. They will continue to do what they have done throughout the portfolio's history that has led to long-term outperformance. There has been a pick-up in mergers and acquisitions (M&A). Two thousand seven was also a strong year for M&A activity, and Jennison benefitted disproportionately in that period when there were 13 or 14 buyouts in the portfolio. It is not part of their investment strategy to invest in companies they believe will be bought out, but the metrics of the companies they buy are what large cap companies are looking to acquire to spur their earnings growth, or what private equity firms - with a lot of money on the sidelines, are looking to acquire. So in periods of high mergers and acquisitions, Jennison has tended to do well. There have been two buyouts in the portfolio that were announced this year, but the pace has slowed down over the last month when there was a bit of market turmoil.

MR. O'LEARY commented that small cap stocks have done better than large cap stocks for a protracted period now, and six or seven months ago people were saying that large cap was the place to be. He asked why small cap was continuing to do better, when it appeared to be more expensive.

MR. SWIATEK replied that small cap stocks are trading at a slight premium to large cap stocks, but valuations are within historical norms, based on the metrics that Jennison looks at. They believe that, in a sluggish growth environment, small cap companies can often be more nimble and find opportunities to gain market share. The higher quality companies that Jennison focuses on can perform relatively decently in a slower economic growth environment. Secondly, in a mergers and acquisitions environment, as small cap companies get to 12 or 13 times earnings, large cap companies will put the cash on their balance sheets to work and buy out these companies. Right now, those large cap companies are basically earning zero on their money and are under pressure to engage in mergers and acquisitions. Because there are other buyers looking at the small cap businesses as well, it prevents the businesses from becoming too cheap. So small cap stocks are not so much in a superior position to large cap stocks, but they are equally positioned.

MR. MASTIAN added that large cap companies are followed closely by analysts on Wall Street. With the changes over the last few years, where investment banking can no longer cross-subsidize the research, fewer and fewer small companies are being followed. Jennison's small cap team actively follows 500 small cap companies, so there is an information advantage in the way they manage the small cap portfolio.

MR. SWIATEK said they also meet with customers, competitors and suppliers to understand what is happening in the various industries. Further, the growth in electronic trading has pressured commissions for the larger research shops, and they tend to follow companies that trade 500,000 shares or more a day versus small companies that trade 5,000 to 10,000 shares a day. He has found, in the 12 to 13 years that he has been doing this, that the active manager with deep resources has a greater advantage to add value within the small cap space than they could historically.

Referring to the table of sector weights in the slides, MR. BADER asked how Jennison makes a decision to add a stock or delete a stock from the portfolio, and how much bearing the sector of a stock has on that decision.

MR. SWIATEK responded that the seven investors on the small cap team are organized by industry, but each analyst will follow about 70 to 90 companies in total. So, on a constant basis, the investment professionals are evaluating the holdings compared to the rest of the portfolio, but also evaluating the other opportunities that they have within their universe of 70 to 90 companies that are above average and that can grow 10% to 25% on a sustainable basis. He said he and John Mullman, the co-portfolio manager, often look at the appreciation potential of the entire universe. If they see that technology is showing a lot of appreciation potential but that the portfolio is only equal weight or marginally underweight in technology, they will go to the analyst for that sector and ask them to look through their universe for some potential holdings. The same would work in reverse. If the portfolio is already overweight in technology, and the portfolio managers see that industrials, for example, are showing a lot of appreciation potential, they will ask the analyst for technology to scale out of their lower conviction idea in that sector as they are buying a new position in the industrial sector. Jennison calls itself benchmark aware: if they are currently overweight a sector, for each incremental idea they have, they will look at the lower appreciation potentials and ask if they should sell a position to make room for a new position. Conversely, if an analyst has a sell recommendation in a sector that is already underweight the index, they will consider the underweight in making a decision. They do not consider themselves home-run hitters and try to make very large industry bets. Their competitive edge is, on a day-to-day basis, finding businesses that can grow above market rates on a sustainable basis, and then patiently waiting for an opportunity to buy those businesses.

At MR. BADER's request, MR. SWIATEK spent a few minutes explaining in more detail how the small cap team calculates the appreciation potential of a company using three years of earnings experience and then sets a multiple to get a target price. They can then compare the difference between the current price and the target price, or the appreciation potential, for all the companies in the portfolio and all the companies in the broader universe of 500 companies. The appreciation potential is what they believe is the up side in that stock over a period of three years.

There were no other questions, and CHAIR SCHUBERT thanked the gentlemen for their presentation before calling a brief at-ease ahead of the next agenda item.

11. Luther King Capital Management - Small Cap Equity

MARK JOHNSON, a portfolio manager with Luther King, and STEVE PURVIS, co-manager of the small cap strategy, appeared in front of the Board to talk about the portfolio they have been managing for the Alaska retirement fund since April 2005. *[A copy of the slides for this presentation is on file at the ARMB office.]*

MR. PURVIS stated that the firm came through the bear market stronger than ever, with strong client retention and staff retention. They are well-positioned to face the next challenges of the market. He listed three things that give them a competitive advantage:

(1) being an independent firm that is big enough to have all the resources necessary to be successful but also small enough to be timely and dynamic enough to take advantage of market opportunities in a client-focused culture; (2) being a broad-based equity manager so they have a better vision of the overall market and not just of small cap equity; and (3) having a stable and experienced team and analyst resources to support the small cap strategy.

MR. PURVIS reviewed the investment strategy, saying Luther King is a high-quality manager, a growth-at-a-reasonable-price manager, with a bottom-up approach that uses the knowledge and experience of their analysts and investment professionals to drive results. The strategy is to identify the very best profitable companies, ones that are competitively advantaged, that can generate a high return on invested capital, and that can internally grow the business through good and poor market environments and thus grow the value of their shares. They tend to avoid the start-up or early stage of a company's life cycle, and they also stay away from the mature and declining phases.

MR. PURVIS talked about the risk management process, saying the portfolio is diversified on both a stock basis and a sector basis. They typically manage 90 to 95 names in the portfolio. When investments have become successful and grown, they trim them back, and when the companies exceed $5 billion in market capitalization, they outright harvest the investment to reinvest back into smaller companies. They are not a closet index fund: they make active sector allocation decisions but do not get too aggressive in any one area. They actively manage the portfolio to improve the returns and to decrease the risk. They also have an exceptions report process, a formal review of the fundamentals and price action of all the investments in the portfolio to limit the negative tail of disappointing stocks over time by harvesting those out of the portfolio.

Turning to return data for the small cap core composite, MR. PURVIS stated that Luther King has delivered superior returns to the benchmark over 16 years, with lower levels of volatility. The alpha over and above the benchmark has come from their stock selection. They have captured the bulk of the up move in the market, and they have protected the portfolio in the down market.

MR. O'LEARY remarked that he was not being critical of Luther King using the small cap composite to portray the longer-term performance, but the Board's frame of reference is what Luther King has done for the Alaska retirement fund. The portfolio was comfortably above the benchmark in 2009, and is above the benchmark in the first quarter of 2010. It lagged the benchmark in 2008, was a tad better than the benchmark in 2007, and was a bit worse in 2006. He asked Mr. Purvis to comment on the first three calendar years of the ARMB account, when performance was a bit behind the benchmark, and then the cumulative result that is a tad ahead of the benchmark.

MR. PURVIS stated that their strategy is to add value over longer-term periods, and the last three years were really tough. Compared to prior bear markets, there really was nowhere to hide in this most recent bear market, which took high-quality stocks down and low-quality stocks down almost equally. The ARMB small cap portfolio has had three years where the return basically matched the benchmark. The positive is that in fiscal year 2010, and on a year-to-date basis, the portfolio is starting to outperform the benchmark again. The recent market environment made it difficult for a diversified manager that was in multiple stocks and across a lot of different sectors, because there was extreme volatility in sectors and in companies. Luther King believes the rotation back to high quality companies is beginning and that superior stock selection is starting to be rewarded again.

Drawing attention to a graph of the Russell 1000 Index versus the Russell 2000 Index, MR. PURVIS said he measures quality based on what type of companies are performing and leading the market. On the market bounce-back in 2009, low-quality companies that did not earn money were up 52%, while companies with the highest level of profitability were only up 28%. The real small micro cap stocks were up 48%, while companies with over a billion dollar market capitalization were only up 11%. Stocks priced below $5 were up the greatest. It is not atypical coming off the bottom of a bear market to have a low-quality stock rally before the market rotates back into quality companies. Luther King believes the market is right at that point, which should serve their investment strategy well because they are a quality manager.

MR. PURVIS showed a graph of the Russell 2000 Index historical results from December 1979 to May 2010 to illustrate his point that in prior bear markets active managers, like Luther King, could rotate the portfolio to protect better on the down side and actually make money. The most recent bear market took all the stocks down dramatically. They feel that the market has gone past the initial bounce-back from the bear market and has reached the point where selecting quality companies will be rewarded as the economy continues to expand. Those are the businesses that they invest in. An attribution analysis shows they have added about 200 basis points above the benchmark calendar year to date, and the positive has been stock selection, especially in the consumer discretionary sector, health care, and materials. Typically, they are not more than 500 basis points overweight in a sector; consumer discretionary is a little bit above that, but that is mainly from strong price performance of the holdings. The portfolio is underweight in the financial sector, although they have increased it lately. Because of strong performance in financials, the underweight has been a slight negative to the portfolio, although their stock selection has been solid in the area of financials.

MR. PIHL cited the 16% drop in the ARMB's small cap portfolio at Luther King in 2008 and the 26% drop in 2009. He said it looked like the portfolio had recovered about half that loss since then, and he asked about the prospects for getting the rest of the asset value back.

MR. PURVIS replied that he thought it was highly likely, but it would take time. As the U.S. economy and the global economy recover and grow, the value of companies should also increase as their earnings increase. Luther King believes, looking at the current valuations and current sentiment in the market, that over the next two to three years there will be a very solid return market — probably not the 30% return seen last year — but they think they can continue to add and grow the value of the portfolio going forward.

MR. O'LEARY referred people to Luther King's slide of their small cap core composite performance from October 1994 to March 2010, saying it was maybe helpful in addressing Mr. Pihl's question. He said the last decade had two market crashes, and we have the first market crash and the recovery from that to see how things progressed. The bottom line is that, cumulatively, there has been a great advantage to managing in the approach that was applied.

MR. PIHL said his concern was that the U.S. does not produce much anymore, and something fundamental has happened to the economy that the country will never get back to. He asked for comment.

MR. PURVIS stated that small companies should continue to do well and outperform in the future because they are smaller, have more control of their own destiny, and are more agile to change to the varying market environments. He concurred with Mr. Pihl about the notion that it feels like the economy is slowing. One has to think about all the leverage that was used in the economy over the last 20 years to achieve the growth rates that occurred, and that as the leverage is unwound, one could conclude that the overall growth rate will be lower. He thought, however, that small companies can continue to execute and do well.

MR. PURVIS next discussed the top five contributors to the ARMB portfolio's return so far in 2010, as well as the bottom five contributors to return. In a market that was up 6% on a year-to-date basis for small cap stocks, the top five stocks in the portfolio were up from 41% to 58%. At the other end, some stocks had negative returns. They use their [exceptions report] process to reduce or eliminate that negative tail to shift the performance to the positive. There are opportunities for individual companies and parts of the market to do well and flourish, even if, at the macro level, the country is entering into a lower-growth environment going forward.

MR. JOHNSON mentioned the bear markets of the early 1970s and the early 1990s when people could have walked away with the same feelings that Mr. Pihl expressed earlier. In both of those time periods there were significant discussions in the media and in the press about structural changes in the economy and how things were never going to be the same again — and those were, indeed, challenging times. Everyone at the end of 1999 was excited about equities, and now, halfway through 2010, we have had two bear markets and a near financial collapse. Fear is rampant and very understandable. Interestingly, as the global economy has grown over the last five decades, the U.S.'s share of that has been very stable at about 30% of that growth. The country has not really lost ground. The economy has changed in terms of manufacturing, and there are a lot of services and other things that the U.S. provides on a global basis. An environment that is light on taxes, less intrusive on regulation, and has free trade and a strong dollar, is ideal. We are looking at a period where there may be some difficulties with those issues and, thus, the overall growth rate will be hampered some. But Luther King believes, with good stock selection and better companies in the portfolio, that they should gain in excess of that economic growth. They expect to see good economic growth, probably not as strong as people have been used to in the recent past, but hopefully that will improve.

MR. PURVIS reviewed the characteristics of the ARMB small cap portfolio, pointing out that no positions are over 2.0%, so they do not let individual stock holdings get outsized. There are no dollar or penny stocks among the holdings, and, on a market cap basis, they continue to be a small cap manager. If the country is going to enter into a slower growth overall macro environment, Luther King believes that good capitalized large companies will be very active in putting that cash to work in the mergers and acquisitions area. These large companies will be acquiring the strong and very best small companies, the kind that Luther King tries to put in their portfolio. The portfolio return-on-equity is above the benchmark, and it has a better valuation and a better price for that opportunity.

Wrapping up, MR. PURVIS said the last three years have been the toughest since Luther King began managing small cap stocks. But they feel good about their approach and strategy, about the people who are executing the strategy, and their ability to add value as they go forward.

CHAIR SCHUBERT thanked the gentlemen for the presentation.

12. Actuarial Review

12(a). Actuarial Valuation Review - Certification of Draft FY09 Actuarial Valuation for Defined Contribution Plans

LESLIE THOMPSON, with Gabriel, Roeder, Smith & Company (GRS), the reviewing actuary for the ARMB, said she had three items to report on, two of which the Board had seen already in draft. *[Copies of all the GRS reports are on file at the ARMB office.]*

MS. THOMPSON said GRS audited the actuarial work of Buck Consultants, the state's primary actuary, on the Death & Disability Plan and the Retiree Medical Plan for those members that are in the Defined Contribution Retirement Plan (DCR). They had one finding, and the rest were recommendations. For a small portion of the population (peace officers and firefighters), Buck was using a five-year averaging period for calculating monthly disability benefits, instead of a three-year period. The result was that, for the 2009 valuation, the liabilities for the disability benefit are understated. It was a very minor issue that made a 1/10th of 1% difference on the contribution rate. Buck has agreed to change this for the 2010 valuation.

She said the DCR is a new plan, and GRS had some recommendations that they thought would be beneficial to everyone if they were added to the valuation. She listed the recommendations, as follows:

- That future valuations contain a "participant reconciliation grid" that traces the change in a person's status from the beginning of the year to the end of the year, so that the changes in the population can be seen from year to year. It is a valuable tool to make sure that everyone is accounted for.
- That future valuations contain a "gain/loss by source" analysis, so the trustees can see the liability impacts from the various key assumptions, because things could be a little more volatile in a brand new plan.
- That the amortization method description be enhanced to include the fact that it is a year-by-year closed method, rather than an open amortization method.
- That the 100% assumption rate used for the retiree medical portion of the plan be reviewed as part of the ongoing experience study.
- That details regarding the provisions of the retiree health care plan which affect the claims costs be added to the valuation report. Buck's development of the claims costs was based on the difference in plan provisions between the legacy health plan and the plan for new hires. GRS became concerned about whether they were valuing a plan that truly existed because they could not find the actual medical plan for retirees when they were directed to various sources.

MS. HARBO asked DRB Director PAT SHIER if there was a medical plan for retirees in the defined contribution plan, and if so, where she could get a copy.

MR. SHIER replied that the state has a general description of a fairly standard medical plan with a deductible and a copay. The division began working with Buck Consultants about a year ago to create a different kind of a plan that was more modern. The plan had some features of chronic disease management, such as waived deductibles for chronic disease if people were compliant, as well as some other fairly unique features. The draft plan was presented to the ARM Board at one time, and it has not changed materially since then. There is no completed plan booklet, as that work stopped essentially when the Patient Protection and Affordable Care Act passed Congress and was signed into law [March 2010]. The thought was that anything produced or printed would likely be superseded by the new law.

MS. HARBO said she could not recall seeing a draft health plan for DCR.

MR. WILLIAMS said the ARMB Health Care Cost Containment Committee had received a high level draft overview of the plan at one time.

MS. HARBO said committee members saw something, but they never got an actual paper. She expressed concern that there is no health plan to use when talking about making the [retiree medical] valuation.

MR. SHIER stated that the division would proceed to put together a retiree booklet. The plan that was originally thought about and written down in terms of a deductible and a copay is still out there for description and for use in valuing what expenses may occur going forward. The division is hoping to have even better experience once the new plan is fully in the valuation. He said that Christopher Hulla of Buck Consultants was in attendance and could help bring the Board up to date on how the current plan description was affecting the valuation for the DCR defined benefit retiree health plan.

MS. HARBO asked if she could get a copy of what a defined benefit retiree would be given upon retirement this year. MR. SHIER said yes, that it was the 2003 version, which is available in print and on the DR&B web site.

Continuing with her report, MS. THOMPSON directed trustees to an exhibit showing the differences, if any, when GRS tested actual lives in the DCR PERS and TRS pension plans for the present value of benefits as of June 30, 2009. She stressed that all their numbers matched Buck's calculations very closely. Another exhibit showed the results of the test lives matching for the DCR retiree health plans, which also closely matched Buck's numbers.

MS. THOMPSON stated that Buck Consultants provides GRS with a lot of data and is very good to work with. She does a lot of auditing around the country, and this is one of the most successful audits because Buck is so forthcoming with data and in answering her questions.

MR. TRIVETTE thanked Ms. Thompson for making the information available to the Board [about the lack of details for the DCR health care plan provisions used in the DCR retiree medical valuation]. He said that getting that health care plan on paper needs to be a high priority so GRS has something concrete to look at; otherwise it is a waste of money to have a second actuary look at the primary actuary's work. It has been almost two years since the Health Care Cost Containment Committee briefly discussed a high level plan, and the bill [SB 141 creating the defined contribution plan] passed in May 2005.

12(b). Certification of Final FY09 Actuarial Valuations for PERS/TRS and NGNMRS/JRS Roll Forward Analysis

MS. THOMPSON reported that GRS found no issues to bring forward on their review of the PERS and TRS valuations. She had mentioned at the April meeting that there were persistent losses in the demographic assumptions on the retirement plan and persistent gains on the retiree medical. The recommendation had been to look at those assumptions as part of Buck doing an experience study. GRS is presently reviewing that draft report, with the expectation of giving the Board a report at its September meeting. GRS's review of the National Guard Naval Militia System and the Judicial Retirement System roll forward analyses conducted by Buck Consultants found that they looked fine, as well.

MS. HARBO moved that the Alaska Retirement Management Board formally accept the review and certification of actuarial reports by Gabriel Roeder Smith & Company, and that staff coordinate with the Division of Retirement and Benefits and Buck Consultants discussion and implementation of suggestions and recommendations of the reviewing actuary where considered appropriate.
MR. PIHL seconded.

There was no further discussion, and the motion carried unanimously, with seven members present.

MS. ERCHINGER stated that it gave her a lot of comfort that GRS was auditing the work of the primary actuary to make sure that everything they were doing was reasonable. Regarding Trustee Trivette's comment, however, auditing someone else's work is one thing, but auditing the underlying information that they are using to base their work upon is another. She asked Ms. Thompson if GRS does any kind of review of the contribution rates recommended to the Board to determine whether or not the overall outcome is sustainable. To her, how the rates are compiled makes sense, but the question bothering her was whether those rates were reasonable or sustainable for the State of Alaska down the road. For example, the State's on-behalf contribution to PERS and TRS in 2010 is $336 million, and in 19 short years that contribution will jump from $336 million a year to almost $1.3 billion.

MS. THOMPSON responded that GRS is only auditing the actuary and not looking at the issue of sustainability on behalf of the State.

CHAIR SCHUBERT called a scheduled break from 2:49 p.m. until 2:59 p.m.

12(c).FY09 Actuarial Valuation - Defined Contribution Retirement Plans

MICHELLE DELANGE and CHRISTOPHER HULLA of Buck Consultants, Inc. attended the meeting to make a presentation of defined contribution plan actuarial valuation results to the Board, as well as to talk about how the State contribution assistance works and to review the 30-year projections for PERS and TRS. *[A copy of Buck's slides used for both their reports is on file at the ARMB office.]*

MS. DELANGE mentioned that this was the third valuation that Buck had done based on actual participants who had joined the DCR plan after it went into effect July 1, 2006. She explained that two pieces of the new tier of benefits for DCR members are defined benefits: the occupational death and disability plan and the retiree medical plan.

In response to questions raised earlier by trustees, MR. HULLA said he would not attempt to address the presence or absence of a health plan booklet, but he wanted to explain the valuation for the DCR retiree medical plan. He stressed that the actual calculation was a function of the claims costs that arise historically under a set of plan provisions. The best predictor of what next year's claims will be, let alone 30 years from now, is what last year's prescription, medical and hospital claims looked like for a similar population. For the pre-DCR tiers, Buck certainly looks at the plan provisions each year to make sure the data makes sense. How the DCR medical plan is valued is a straightforward process, because the central concept is that 80% of the costs will be borne by the plan and 20% by the members in terms of out-of-pocket.

MR. HULLA stated that there is no past history of claims under the DCR plan, so Buck looks at the gross claims of a similar group, meaning the pre-DCR tiers, before applying plan provisions. That gives them an idea of how much health care is being utilized. In simple terms, they project that trend forward and take 80% of it in the DCR environment.

MR. TRIVETTE said that sounded okay, but there were a lot of other more complicating factors, such as assuming that 100% of the people were going to take advantage of it [health plan?]. That is a big issue out there that has to be looked at carefully, but there are other issues that need to be part of Buck's valuation process. He asked if there were other defined contribution plans out there that Buck could look at, similar to Alaska's DCR plan. Also, there were very specific provisions in SB 141 regarding what a member had to do to be eligible for the health plan, such as how long a member has worked, and having to work for an employer the full year prior to retirement. Those are not the same kinds of retiree health care provisions as the previous tiers. Further, he was curious as to how Buck was going to figure out how many DCR people might ever get there [to access the retiree health care], because he thought it would make a huge difference in the calculations.

MR. HULLA stated that his earlier explanation about Buck using the claims costs [for the retiree medical valuation] was analogous to calculating the amount of annuity that a retiree might receive on the pension side of things. They would certainly apply all the eligibility provisions before the annuity ever started. For example, in the few circumstances where a DCR participant might access the health care benefit prior to Medicare eligibility, it would be "retiree pays all" at that point, in most cases. That is all factored into the valuation, just like on the pension side. In the current plans, the potential for someone to leave employment with some vesting and then return to work, or even leave the plan once retired and then come back, that is a loss that occurs in the valuation of the current plan [tiers I, II and III). In the DCR calculations, since no one has left with any service to speak of, Buck does not project any return to work or retirement. So, by default, that different aspect of the plan is built into the valuation process because Buck bases it on a closed group of employees and future retirees, and they make no assumptions in either valuation about anybody coming back.

MR. TRIVETTE said a big issue is that he guessed that 25 or 30 years from now a substantially small portion of the DCR plan population would ever be on any DCR retiree health plan. Currently, a large number of retirees left government service long before they retired, for lots of reasons, but they were eligible for the retiree benefit when they reached a certain age. He asked again how Buck calculated that, because obviously it would have to be one of the things that impacted plan costs.

MR. HULLA stated that the 100% participation assumption would only occur if and when the current actives in the DCR plan were to make it through all the decrements. Those decrements are not impacted by the health plan booklet; and they are resulting in a much smaller per active [missing] time and medical liability than under the current tiers. The single biggest reason is because the health benefit is essentially deferred to age 65, and because there is a different premium structure. That is all built in using the assumptions about turnover and rates of retirement and when they are triggered at the ages that someone can actually retire and get the benefit.

MR. SHIER asked, to be clear, if Mr. Hulla was saying that Buck was taking into account assumptions that a number of people would never make it to that age, that some people would die too soon or and that others would leave for other careers, and never take advantage of it [retiree health care]. MR. HULLA said that was correct.

MR. TRIVETTE said he wanted to see that information and how Buck comes up with those determinations. He added that the State's DCR plan is somewhat unique, and he was questioning whether or not there is actually a factual basis for how the plan will look 25 years from now. If Buck was using information from some other defined contribution plan(s) to come up with its figures for PERS and TRS, he wanted to know that.

Board legal counsel, ROB JOHNSON, said he was not sure how the process has been presented or considered, but he wondered, if the Board was expected to approve or set a contribution rate for the DCR plan, if it should be approving the assumptions that go into it, similar to what is done on the defined benefit (DB) plan. He thought the question went to what Trustee Trivette was suggesting.

In response, MS. DELANGE stated that Buck is in the process of completing the experience analysis, which includes the defined benefit plans and the DCR plan. Buck will have a full recommendation on how the DCR assumptions might be changed, based on the experience. They looked at the defined benefit plan and applied some reasonable adjustments to the DCR assumptions based on what they know about the DCR plan and how they expect people to behave because they have a DCR plan versus a DB plan. Buck's presentation on that will take place at the September meeting in Fairbanks.

MS. DELANGE reviewed the changes for the fiscal year 2009 actuarial valuations of DCR PERS and DCR TRS from the previous year. There were no changes in benefit provisions. The occupational factor for PERS peace officer/firefighter changed from 100% to 75%, and for PERS Others from 100% to 50%, to match the assumptions used for the defined benefit plans. For TRS, the defined benefit plan has an assumption that no deaths and disabilities are occupational. Because the DCR plan is an occupational-only plan, Buck believes the assumption should be higher than zero. So they put in 15% based on some actuarial experience on disabilities and deaths that were due to occupational causes that they looked at for other teacher plans and like professions. The TRS DCR assumption was intentionally set at 100% when these plans were first established because they wanted to make sure, if there was some adverse selection during the first three years, that there was some money built up to pay those benefits. Now, a sufficient surplus has built up for adverse selection and experience, and Buck can change the assumption to something less than 100% to be in line with what they are expecting.

MS. DELANGE reported a change to using compound interest instead of the simple approach in the amortization of the unfunded liability. Lastly, Buck did the same thing they did for the defined benefit plan in making some adjustments for the lag in claims reporting.

Starting with PERS DCR valuation results, MS. DELANGE reviewed the statistics for the past year. The plan has over 7,000 actives now, and compensation for this group was $314 million. The market value of assets at June 30, 2009 is $7.4 million. Buck is using the same smoothing method, so the actuarial value recognizes 20% of the gains and losses since the plan was created. The actuarial value of assets is $8.6 million, meaning some of the losses in the prior years have been deferred. Nobody is receiving benefits from the DCR plan right now, so there were no benefit payments coming out of the plan.

MS. DELANGE explained the calculation of the PERS DCR contribution rate and noted that the plan is overfunded by $4.3 million, and the funded ratio is near 200%. The contribution rate is the normal cost plus an amortization of the unfunded liability, or a surplus in this situation. The fact that the plan is in surplus is actually helping reduce the annual contribution. The total DCR contribution rate is 0.71%, and that includes both the occupational death and disability and the retiree medical.

MS. DELANGE answered a question from MS. HARBO on Buck's calculation of the "% of DCR pay" number in figuring the annual contribution.

MR. HULLA reported the Teachers' DCR valuation results. Membership has grown from 1,200 to 1,800 active employees. Annual compensation is $89 million. Similar to the PERS plan, the market losses are deferred, so the actuarial value of assets is $3.4 million versus the market value of $3.0 million. Building of the annual contribution rate is similar to PERS. The overfunded status of $2 million surplus assets over liabilities leads to an amortization and offsets the normal cost. So the normal cost of $650,000 translates to an employer contribution of $550,000, or 0.6% of pay.

MS. DELANGE next presented Buck's analysis of the State's assistance to the employer contribution. SB 125 capped the PERS employer contribution rate at 22% and the TRS rate at 12.56%. The legislation also said that the State would provide any additional required contribution above the capped rate for both the DB and DCR plans combined. Buck first calculates the rates for the individual plans. The calculations for the DB plans were presented at the April meeting, and the calculations for the DCR plans were presented earlier in this meeting. The DB contribution rate is calculated over total payroll (DB and DCR combined). The results for the DCR plan are just on the DCR payroll. Buck has to get those two rates on an apples-to-apples basis, so they convert the DCR plan results to a total payroll basis (slide 12). MS. DELANGE walked through the steps of developing the additional state contribution for both PERS and TRS for fiscal year 2012 (slide 13). Based on Buck's projections, the state contribution for PERS will be $242.6 million and for TRS $234.5 million, for a total of $477.1 million in expected State assistance.

MS. ERCHINGER asked how Buck derived the expected payroll number for FY12. MS. DELANGE said they took the actual payroll numbers for FY09 and, on an individual basis, projected each person's salary for three years based on their scale. The individual salaries were then summed. Buck will be reviewing that in their experience analysis report at the September meeting.

MS. ERCHINGER said there was some discussion at the April meeting, following the report from GRS about the payroll assumption being persistently underestimated for each of the last four years. The Audit Committee at its last meeting talked about whether it makes sense to ask employers that are participants in the retirement system to provide some budgeted personnel information that would perhaps be a timelier and more accurate estimate of payroll costs. The concern has to do with an appropriate assumption for rising salary costs. Some people may say that the State is the largest employer in the system, and if it has not experienced salaries increasing at X percent per year, then that might be a reasonable assumption for the whole system. She said she had mentioned at the last Board meeting that if she, as an employer, was having difficulty hiring people because the new tier of benefits is not as generous, then she likely is going to pay higher salaries in order to attract employees. That, in turn, would mean having to increase the salary scale for everyone in her employ, which would mean those people's retirement income would be based on their highest earning years, and that would result in higher-than-expected retirement costs down the road. If employers in the retirement system could provide the State with estimated payroll costs, it would at least give some assurance about whether the payroll assumptions are reasonable or too low, and maybe identify what else is going on that is not anticipated.

MR. SHIER had a couple questions about the calculation of the 11.49% number for the State's assistance for FY12 that MS. DELANGE answered.

MS. ERCHINGER sought clarification about whether Buck does a true-up if there is a shortfall in the calculated State assistance amount from the prior year that is the result of the difference between the estimated payroll amount used in the calculation and the actual payroll costs.

MS. DELANGE replied that at the time of the valuation, if the contributions are not what Buck expected during the prior year — either higher or lower — there will be a gain or loss on the valuation because of that. If it is a gain, it helps the retirement plan and it will reduce the future contributions. If it is a loss, it will increase the future contributions. So there is not a true-up per se, to look at exactly what happened during the last year and then make a correction for the next year. It falls into the entire gain/loss and becomes self-correcting. For example, if there was a $1.0 million shortfall, that would increase the unfunded liability by $1.0 million, and that would get amortized over the next 25 years to pay for that so-called loss.

MS. ERCHINGER said she expected that it would have been done differently, that when the contribution rate was established this year, it would not take into account the gain or loss from the prior year and amortize it over 25 years. She thought the Legislature expected that the State would pay everything over 22% in the current year, whether it was a $1.0 million shortfall or a $40 million shortfall. She expected that the exact dollar amount, once it was known, would be added to the request to the Legislature in the subsequent year. She acknowledged that it had nothing to do with the work that Buck does, but she wanted that comment on the record.

MR. PIHL had a question about Buck's analysis that came up with a 0.71% rate for PERS medical and occupational death and disability for FY12 and a 0.58% rate for TRS, and how those numbers tied back to the total PERS contribution rate of 8.71% based on DCR pay and the total TRS rate of 10.58% based on DCR pay. He worked it through with MS. DELANGE and MR. WILLIAMS.

Referring to a couple of different pages, MS. ERCHINGER tied the calculation of $243 million as the State's additional contribution in FY12 to the same number in Buck's valuation report. She said it looked like the $57.6 million shown as the PERS DCR contribution was not going into the defined benefit plan.

MS. DELANGE said that was correct, that the $57.6 million was going into the PERS defined contribution plan.

MS. ERCHINGER commented that David Teal of Legislative Finance made that point at the April meeting [when he spoke in support of adjusting the adopted rate to include an adjustment for the defined contribution portion of PERS]. She said she did not understand that point until now, and she thought the Board would probably discuss it at a later time.

MS. DELANGE stated that at the next meeting Buck would be showing those projections again and adding the DCR piece. Hopefully, that will clarify some of what they talked about in April when they did not have the DCR information in front of them to go through.

MS. HARBO repeated a statement she made in the morning session about the Legislature's FY09 appropriation being $10 million short for the Teachers' system and $2.0 million short for the Public Employees' system. She said that while the actuary may want to amortize that shortfall, she wanted that money in the bank right now. Once the actual State assistance amount is known, there should be some way to ask the Legislature for a supplemental contribution so the money gets invested and not figured out over 20 or 25 years.

MS. DELANGE briefly reviewed a summary of all the FY12 employer contribution rates, based on total payroll, as follows: PERS (DB and DCR) 30.76%; TRS (DB and DCR) 42.61%; JRS 48.07%; NGNMRS $895,565; PERS DCR 0.71%; and TRS DCR 0.58%. Total State assistance is expected to be $477.1 million.

MS. ERCHINGER asked for clarification about how much of the State's $477.1 million assistance would go to the defined benefit plans, saying she assumed that some of it would be taken for the DCR plans. MS. DELANGE stated that the $477.1 million was net of the DCR plans and was the amount Buck expected to go into the defined benefit plans. Buck has already accounted for the DCR plans.

MR. SHIER stated that DR&B asked Buck Consultants, after last year's rate setting, to prepare a document that showed the calculation the Board is seeing today, and that DR&B could forward to the Office of Management and Budget to show not only the direct rate but also the defined contribution plan rate effect. He said that David Teal had talked about perhaps resetting the rate such that it was a simple mathematical equation that would be useful to people. DR&B added a statement to the language that explains the adoption of the contribution rates, that talks about the State also contributing an additional amount, and that makes the description of the DCR amount clearer.

MS. HARBO said she found the written explanation very helpful, and she thanked the director for it.

MS. DELANGE next presented the PERS and TRS 30-year projections. She started with a graph of the PERS contribution rates, noting that this graph now includes the DCR contribution rate. The graph showed the total rate dipping below 22% in 2033, when the employer rate would cover all the contribution requirements and the State assistance would no longer be needed.

MS. DELANGE said Buck understood that the retirement plan investments were expected to earn 12.5% for FY10, which is more than the earnings assumption of 8.25%. Buck did some calculations and found that it would reduce the contribution rate 1.2% to 1.4% each year, which would help reduce the amount of State assistance needed over the whole period. Based on the expected 12.5% return for FY10, Buck calculated it would save $850 million in just the contribution amounts over the 30-year period, with no interest adjustment. So anything the retirement plans can earn above the 8.25% assumption will help the State assistance greatly.

MR. HULLA reviewed a graph of the TRS contribution rates from 2010 to 2040, noting that the threshold rate before State assistance comes into play is 12.56%, much lower than the 22% for PERS. He then opened up the discussion for trustee questions.

MS. ERCHINGER stated that, as a representative of an employer in the State, she was very grateful that the State stepped up to cover the contribution needed above 22% for PERS. However, she was stunned at the magnitude of the future requirements for paying retirement contributions and was having trouble grasping the true picture. In 2010 the State was contributing $336 million to the PERS retirement system on behalf of employers above the 22% rate, and in 2029 — 19 years from now — that State assistance amount would rise to $1.3 billion. She could not see how that trajectory was sustainable for the State. She assumed that trustees who have been on the Board longer than her have been having this conversation for many years, but she hoped the Board would be having a major dialogue about this in the future.

MS. HARBO brought up a question that Ms. Erchinger raised at the April meeting related to the PERS historical gains and losses by source and the quite large number in the "Other" category. MS. DELANGE replied that the largest piece of the Other category was members who rehire and start accruing benefits. More minor pieces are people not taking refunds out of the system as expected, or people electing a different form of payment — maybe 100% joint survivor versus 50% joint survivor.

MS. HARBO asked if Buck expected the "Other" number to decline after July 1, 2010, when people in the previous tiers cannot come back into [those tiers]. MS. DELANGE said there could be someone with 15 years' experience who quit in 2001; Buck treats them as a terminated, vested member who will start receiving benefits when they are 55 or 60 years old. That person may only be 40 years old and may come back to work [for a PERS employer]. MS. HARBO asked if that returning person would be under the defined contribution plan. MS. DELANGE said no, that they would be under the defined benefit plan.

MS. HARBO had a request that Buck include in the experience study the percentage changes in both the funding ratio and the contribution rate as a result of any new assumptions. She also asked if Buck used the 1994 mortality table in the experience study or some other table.

MS. DELANGE said she had recalled Ms. Harbo's question from the last experience analysis and had included in the draft report a summary of the changes to the contribution rate and the funding ratio by PERS and TRS separately, and by pension and health care. The study will also recommend some improvements to the mortality table for all the plans, which Buck will talk about at the September meeting.

MR. TRIVETTE said that at the April meeting he had asked for Buck's plan, in writing, on how to proceed, after the Board heard information from GRS on the four areas where the retirement plans had persistent gains or persistent losses over the last four years. He did not see anything from Buck in the meeting packet, and asked if they had prepared any response for the Board.

MS. DELANGE responded that they had not prepared anything for this meeting because they were planning on talking about that issue in the experience analysis report at the September meeting.

CHAIR SCHUBERT ascertained that there were no more questions, and indicated there was an action item on the agenda.

Board Acceptance of FY09 Valuation Reports:
<u>MS. HARBO moved that the Alaska Retirement Management Board accept the actuarial reports prepared by Buck Consultants for the Public Employees', Teachers', Public Employees' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits), and Teachers' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits) retirement systems in order to set the actuarially determined contribution rates attributable to employers</u>. <u>MR. WILLIAMS seconded</u>.

The motion carried unanimously, with seven trustees present.

13. Asset Class Rebalancing Presentation

MR. BADER said this presentation was in response to a request from Ms. Erchinger for a description of the rebalancing process that staff uses and that is reported upon in almost every meeting packet. Rebalance is the term used to describe transactions that are intended to bring actual asset classes closer to the strategic targets set by the Board. The adjustments can be accomplished by moving unit buyers from one fund to another, or it may involve adding or subtracting money from an asset manager to bring funds into balance. This presentation would focus on rebalancing using investment pools, and a future presentation would delve into rebalancing involving asset managers. *[A copy of the slides for this presentation is on file at the ARMB office.]*

MR. BADER displayed a chart of the pooling structure, explaining how 14 different funds are grouped into four broad categories, then the asset class pools that roughly correspond to the Board's strategic asset allocation groups, and finally the numerous investment managers that might be included in an asset pool. He then showed an example of rebalancing the defined benefit components of the defined contribution plans on June 14, 2010: the occupational death and disability account for PERS, occupational death and disability for TRS, occupational death and disability for police/fire under PERS, the major medical account for PERS, major medical for TRS, and the separate health reimbursement accounts for PERS and TRS. He noted that all these funds are getting cash flows at different rates, but people are not going to be calling on the assets for these DCR plans for quite some time.

MR. BADER next used the PERS occupational death and disability account as an illustration of why and how rebalancing takes place. He noted that the same thing would be happening in all seven of the accounts listed above at the same time. Once the buying and selling transactions are done to rebalance the account, the new percentage of each component within a larger asset class will match the target percentage that is the size each component should be of the whole account. When the components are grouped together into one number for each broad asset class, the percentages should be right in line with the Board-approved target asset allocation for the defined contribution funds. Money is then allocated to the PERS and TRS pension funds in proportion to the size of the funds, so roughly 70% to PERS and 30% to TRS.

MR. BADER said staff sends a letter to State Street Bank, the custodian, giving direction and authority to do a transaction. The letter contains a spreadsheet with the transaction details to avoid data entry errors.

MR. BADER stated that approximately $35 million in pension payments flows out each month for PERS and approximately $25 million from TRS for pension payments. Although the PERS fund is almost twice as large as the TRS fund, the monthly outflow is not in proportion to the size of the two funds. These pension payments happen somewhere around the third week of every month. Freeing up cash from the DCR plans helps meet the pension payment obligation. Sometimes, instead of taking the DCR cash, staff might rebalance by going to the health trusts. The PERS health trust net contributions, minus outflows, are about $4.0 million a month, and it is about the same for TRS. It is beneficial to all the funds involved to use that cash because staff does not have to go to the market to buy and sell equities and incur the transactions costs. At this point in time, with the growing plans and the maturing plans, staff is able to use them both in conjunction with one another to benefit the system in its entirety.

MR. BADER next described the second rebalance of PERS, TRS and JRS, which takes place after the DCR funds rebalance. A transfer takes place between the funds for each asset class. The objective is to bring the non-cash assets into parity across the funds without necessarily bringing cash to zero.

Once the rebalancing is complete, all the asset classes for PERS, TRS and JRS are generally aligned with one another, except for the cash line. The rebalanced allocations are compared to the ARMB target asset allocations. Private equity is overweight; it is an illiquid asset class, and the only way to lower that overweight would be to direct managers to liquidate, which would not be beneficial to the pension funds. Absolute return is slightly overweight. Cash is overweight, but the State will use that to pay benefits in the days following the transaction. Also, the Board's new target asset allocation starting July 1 will have a 1% allocation to cash. It would not be beneficial to invest the money in equities for a few days and incur the transaction costs and then sell them again to get cash. For this second rebalancing, a letter is sent to State Street Bank to rebalance PERS, TRS and JRS according to the directions. When the letter is written, it is assuming that everything will stay still. A significant market event could occur that could nullify the rebalancing objectives, but generally it works out well and the portfolio stays within the target asset allocation bands.

MR. O'LEARY asked about the staff time it takes to come to a conclusion on how much to rebalance. MR. BADER said that for the rebalancing he just described it does not take much time at all because it is only transferring between pools. The staff process is that every week section leaders give him a summary of what they are doing, and Ms. Hall also gives him the status of the funds, which she compiles from work done by research analyst, James McKnight. Sometimes, Mr. McKnight will see things out of balance, and the CIO and staff will deal with it before the reports come from Ms. Hall. It is the rebalancing among the investment managers — for example, to try and stay style neutral in the various equity categories — that takes a lot longer, and it also means having to give managers lead time to do transactions and so on.

MR. O'LEARY mentioned that the real assets category has both liquid and illiquid assets, and he asked how staff dealt with rebalancing there. MR. BADER responded that the liquid assets are the REIT fund and the TIPS fund, which are not very large amounts, perhaps $50 million apiece. When there is a big infusion of cash into the account, he will probably bring TIPS and REITs up closer to their target allocations and then juggle between those.

MR. RICHARDS said he thought Mr. Bader would have been using the word "bands" throughout the presentation, but he did not hear it until the very end. He asked, if an asset class was constantly running down at the bottom band of its target allocation, if staff would try to rebalance to the middle of the band or to the top of the band.

MR. BADER replied that he tries not to let the asset allocations get to the extreme of the bands. But sometimes an extraordinary market event will bring allocations down toward the bottom band. He will generally try to bring an allocation halfway back and not necessarily go all the way back to target, because he does not like to make big bets. He might look at it again in a couple of weeks if an asset category is still off the target and could bring it closer to target then. That is a preference of the CIO more than it is a Board policy. There are numerous investment papers written on the best way to rebalance a portfolio, and he asked Dr. Jennings for his opinion.

DR. JENNINGS stated that bringing an allocation halfway back is actually one of the most lauded approaches in academic literature. The approach balances the transaction cost of trading with the fact that the allocation will drift back to wherever, regardless of where it is rebalanced to.

MR. RICHARDS inquired if State Street Bank was expecting staff's letter of direction to do a rebalancing about the same time each month or if it was random.

MR. BADER explained that staff recently communicated with Ms. Healy at State Street, and they agreed upon a date slightly past mid month to take care of rebalancing directions in the asset pools. By then, State Street will have received most of the private equity return information. If the rebalancing requires an investment manager, then all bets would be off as to the date for State Street to do the rebalancing. Generally, they communicate and it is not a surprise to State Street.

MS. ERCHINGER asked if staff was rebalancing monthly. MR. BADER replied that staff has been rebalancing more frequently than that, but the agreement with State Street to have a monthly rebalancing date just took place in the last week. He said he talked to the research analyst about possibly setting up macros to rebalance using just the liquid asset classes, because he does not want to let money stay in cash too long. He will see how the new arrangement works, and they can always change the agreement with State Street.

MS. ERCHINGER thanked Mr. Bader for using excellent examples to make such a complex topic so easy to understand. She asked if staff rebalances to the target anyway if an asset class is within the bands, or if they make a judgment that it is not worth the transaction costs.

MR. BADER stated that the rebalancing is less frequent if they are just looking at the PERS and TRS pension and the PERS and TRS health trusts. But since there is cash, and those funds need cash, the defined contribution plans benefit from not holding cash. That is when staff does the rebalancing transactions he described in the first example. However, if broad domestic equity is at 30.1%, they are not going to sell equity to get back to the 30.0% target.

MS. ERCHINGER said the subject matter was fascinating to her, and she thanked fellow trustees, who might not have been as interested, for bearing with her request for the presentation.

RECESS FOR THE DAY

CHAIR SCHUBERT recessed the meeting for the day at 4:26 p.m.

Friday, June 25, 2010

CALL BACK TO ORDER

CHAIR SCHUBERT called the meeting back to order at 9:00 a.m.

REPORTS (Continued)

14. International Small Cap Manager Search

MR. O'LEARY described the manager search process at Callan that resulted in a list of seven managers being submitted to the ARMB staff for further consideration. He said Callan's work was based on the assumptions that the Board intended to select two international small cap equity managers who would be somewhat complementary, that the allocations were tentatively set at about $100 million apiece, and that Callan should explicitly consider existing managers who were already providing portfolio management services to ARMB.

MR. BADER said that once he received Callan's list of seven managers he, Ryan Bigelow, and Sean Howard independently reviewed the managers and then came together to exchange ideas about which of the candidates would be best to bring to the Board for selection. In that process, they wanted to make available to the
Board the ability to have choices related to growth versus value investment style; they took into account historical earnings performance; they scrutinized the growth of assets under management and discussed whether the long-term record was likely to be achieved in the future; and they were mindful that the number of investment manager relationships is very large already - given the responsibilities of the Treasury Division. The staff evaluation team settled on three managers to bring to the Board, based on their best judgment of what the Board would like to see, in terms of the ability to negotiate fees and the prospects for good returns. Those managers were Lord Abbett & Company, Mondrian Investment Partners Limited, and Schroder Investment Management.

MR. TRIVETTE asked if the managers' performance was measured against one index or more than one.

MR. O'LEARY said that was an important differentiating question because the ARMB already has a strategic commitment to emerging markets. In the search process, Callan was trying to focus on small cap equities within the developed markets, and they used the EAFE Small Cap Stock Index as the primary benchmark. Callan did not arbitrarily exclude managers who had some emerging markets exposure. Those managers that had that are most appropriately compared to the MSCI All Country World ex-US Small Cap Index, which has 20% emerging markets. None of the three managers the Board was interviewing have extensive emerging markets exposure.

Each manager was allotted 30 minutes to make a presentation before the Board.

14(a). Lord Abbett & Company

The firm's director of public fund services, KRISTIN HARPER, introduced managing partner DARIA FOSTER, and TODD JACOBSON, the portfolio manager for international small cap equity. MS. HARPER said they valued the existing relationship with the Alaska retirement fund in managing a domestic small cap portfolio. *[A copy of the slides used in the Lord Abbett presentation, plus backup information, are on file at the ARMB office.]*

MS. FOSTER said she had been at Lord Abbett for over 20 years, and she became managing partner in 2007. She said the firm sees itself as the steward of its clients' assets. She hoped, over the five years that Lord Abbett has been working on the domestic small cap account, that they had demonstrated the seriousness with which they accept the responsibility to manage money for the ARMB and how they hold themselves accountable for the results.

MS. FOSTER said the firm is an independently owned private partnership, and that partnership concept really came home to everyone at the firm in the last couple of years. It was a difficult time in the financial services industry, and it was a difficult time at Lord Abbett, but they remain stable and solid. They committed to communicating more fully with the clients, to make sure clients knew that Lord Abbett was still working in their best interests and that the firm could take the long term view.

The firm's commitment is to have an intellectually stimulating and challenging culture for the portfolio managers, but also an environment that is comforting and stable. They want the portfolio managers to know the firm is taking the long-term view. Portfolio managers are compensated on performance over a three-year and five-year basis, and not on assets under management.

MS. FOSTER said Lord Abbett strives for product excellence, meaning not just strong consistent performance, but excellence in all the other areas, like training capabilities, strong client service, and a robust infrastructure with operations and technology to support the investment disciplines. Lastly, growth makes people want to be at Lord Abbett; growth allows them to continue to reinvest in the business, which is essential; and growth keeps them relevant to the clients. Growth has to be thoughtful and controlled, and it is within that context that the firm expanded into international markets.

MS. FOSTER stated that Lord Abbett was long a player in domestic equity and fixed income markets, but they knew that having an international capability would further their understanding of the domestic companies that are very global in nature. Also, their clients were looking for international capabilities. That all came about in 2003, with Harold Sharon and Vincent McBride heading up the international team, followed a year later by Todd Jacobson joining. The firm's assets are equally divided between equity and fixed income, and their international capabilities are in small cap equity space, international core, and international large cap.

MS. FOSTER said the international team has been in place for seven years and has established processes that are attracting clients. The firm is committed to reinvesting in this area. The international small cap team works very closely with other portfolio managers.

Before Mr. Jacobson started talking about the investment philosophy and process, MR. O'LEARY asked him to briefly describe the difference between the S&P Developed ex-US Small Cap Index and the MSCI EAFE Small Cap Index, because the material the Board had seen used the first index for return comparisons.

MR. JACOBSON said there are about three indices that can be used for international small cap equity: MSCI, Russell and S&P. When the Lord Abbett team started managing the international small cap product 5-1/2 years ago, they analyzed each of the respective indices. The correlations among the three over a three-year or longer period are very, very high, but there can be deviations over shorter periods. Lord Abbett chose the S&P index because for the MSCI 5-1/2 years ago there was not enough support infrastructure for questions or issues that might come up in terms of small cap index construction. The S&P had built an extensive infrastructure to deal with its index, and the index also had very specific rules as to which securities would actually go into the index. The MSCI at that time was not rules-based at all. Lord Abbett's decision on an index also had a commercial aspect. They did due diligence in the marketplace and looked at what the consultant community and institutional clients were using to evaluate international small cap managers, and the vast majority were using the S&P Developed ex-US Small Cap Index.

MR. JACOBSON said the major difference between the EAFE Small Cap Index and the S&P is Japan. Five years ago, Japan was 37% of the MSCI EAFE Small Cap Index, while it was 24% of the S&P Developed ex-US Small Cap Index. Today, Japan is about 20% of the S&P and well over 30% of the MSCI. Lord Abbett's view is that over a long enough time period — three to five years or more — Japan is likely to underperform other parts of the world because of the demographic issues they face and the low returns on capital. Lord Abbett wants to be evaluated against the toughest possible index because that raises the bar for them. The S&P Developed ex-US Small Cap Index is the tougher index to be compared against because the Japan component is significantly smaller.

MR. O'LEARY and MR. JACOBSON also briefly discussed Canada's and South Korea's share of the S&P Developed ex-US Small Cap Index.

MR. JACOBSON explained the start of the international small cap core equity product at Lord Abbett in 2005, which had $170 million in assets and a view that their capacity was $2.0 to $2.5 billion. Today, the product has about $500 million in assets. From day one, the investment team, when they thought about liquidity or position sizes, was managing as though the portfolio was at full capacity. That way, when they showed a five-year track record, they could convincingly say that the performance numbers people were looking at could be generated at much larger asset sizes.

MR. JACOBSON briefly talked about the international small cap equity investment team, noting that he and Edward Allinson are the two portfolio managers totally accountable and responsible for the performance of international small cap, along with one dedicated analyst in the global sector research section. He said Harold Sharon and Vincent McBride manage the large cap international products at Lord Abbett, defined as companies with market capitalizations above $2.0 to $2.5 billion. The international small cap product is defined as companies below $5.0 billion in market cap. The overlap is considered a strength because the portfolio managers of international large cap and the portfolio managers of international small cap can share ideas and resources across the entire international platform. There is tremendous continuity among the ten investment professionals, having worked together at Lord Abbett and elsewhere for 15 or more years.

MR. JACOBSON said the investment team is structured along sector lines, and his sector responsibilities are industrials and technology. The beginning of his career was all about Japan, where he once lived, and Japan's strengths are industrials and technology. Mr. Allinson covers financials for the team, a business he has been in for over 20 years, and he is an expert on Asia ex-Japan. Mr. Allison has also managed global assets in his career. The team is structured along sector lines because business models and valuations have converged globally. A key advantage to Lord Abbett's approach is that they look at what business models have been successful in different parts of the world and, because of globalization, can speak to management teams throughout the world and talk about why they are doing certain things and can compare it with business models elsewhere.

Another important aspect of the international small cap equity team is that they are all located on one floor of their office in Jersey City. They hold two formal meetings per week, and they have quarterly reviews of every sector and every major region of the world. This is a very deep resource for them.

MR. JACOBSON outlined the international small cap philosophy, which is very bottom-up and fundamentally oriented. This is one of the areas of asset management where it has been shown over time that active managers can consistently add value and alpha versus the index. One reason is that international small cap is a huge universe in which to identify great ideas. Second, Lord Abbett structures its research globally, and they have the ability to look across borders and make comparisons in industries. The investment team spends a lot of time traveling and meeting companies, as well as talking to those companies that come to New York. The platform probably sees over 2,000 companies per year.

MR. JACOBSON reviewed the international small cap equity investment process next. He said one of the biggest challenges in international small cap is taking a very large, addressable universe and systematically narrowing it down to a more manageable subset on which to do greater research. They do that in two ways. They employ multi-factor modeling across sectors, and they also do their own screening process that will differ not only by sector but by where sectors are in a cycle. Last year, for example, they spent a lot of time thinking about industrials. They used metrics like an enterprise value to sales and compared that to operating profitability, and thought through what kind of margins a business could generate over time. Screening financial companies may not provide the full answer sometimes because things can change very dramatically in the financial world, so they need to be able to assess what kind of return profile a company could have in the future.

The second aspect of screening the primary investment universe is called thematic identification. The investment team takes an overview of the world to try to identify those areas with the highest potential for growth and the areas that they may want to avoid. The main strategy Lord Abbett has employed in the international small cap product over the last 18 months is a view that many companies, especially mid cap companies with $1.0 to $2.0 billion market cap or more, are exiting the financial crisis much stronger than they went in. This is because their competitors, who are much smaller companies, have no access to capital and cannot rebuild their inventories. The consequence is that bigger, stronger companies are winning substantial market share in the last 12 to 18 months. The proof of this strategy is in the structure of the international small cap portfolio today, where almost 50% of the securities did not have a single down year through this entire cycle, which is amazing, given what the markets have just been through — and that is because of their positioning.

MR. JACOBSON said that, although the team is structured by sector, they still consider macro, especially when thinking about emerging markets. The larger stocks in emerging markets tend to be highly correlated with global trends, but the domestic securities are still correlated more with what is going on in their specific country. The investment team has incorporated into their analysis what is going on in Europe right now and the trends that are extremely deflationary. The consequence is that the portfolio is underweight on Europe, specifically in the consumer area, but overweight on industrials because of the support and the tail wind that comes from a weak euro and a weak pound.

MR. JACOBSON next talked about Lord Abbett's fundamental research that is used across the platform to evaluate the management and business plan for every security in the portfolio and every security that is in the database and sets a price target for them. But for small cap in particular they need a catalyst, something to unlock the intrinsic value. He also explained portfolio construction, saying that the emphasis is on bottom-up, focusing on the price targets and the ability to see substantial up side over a 12-18 month time horizon. They are benchmark aware but not benchmark focused.

The sell discipline is very important. If something goes wrong with a large cap company, they get small, but if something goes wrong with a small cap company, they disappear. Lord Abbett is very conscious of this, and if something is happening with a company's business plan that they do not understand or agree with, they sell the stock immediately, no matter how cheap it is — because of the risk that is inherent in smaller companies.

MR. JACOBSON reviewed how the international small cap team approaches risk control, saying it is actually hard to implement risk controls within small cap. So they assign a high, medium or low risk rating to each individual security position. Again, what they care about is if a business cannot successfully implement its business model. The higher risk means there are more things that can go wrong because of regulatory issues, country, etc. They are happy to own high-risk companies, as long as they are being properly compensated for the risk. If the process is working, and they have identified the high-risk companies, and the companies start implementing successfully, the companies should graduate up to medium risk. So it is very much a top-down view.

The international small cap equity portfolio parameters are: no individual stock positions above 5%; sector weightings no greater than 25% or 1-1/2 times the benchmark; and emerging markets exposure generally limited to 25%.

Showing a graph of returns since inception of the international small cap account on 3/1/2005, MR. JACOBSON pointed out the fair amount of consistency in outperforming the index, saying it was a proof statement for the investment team, for the philosophy, and for the process.

MS. FOSTER said they understood the Board had several factors to consider when selecting an investment manager. She hoped they had conveyed that the way they manage the international small cap portfolio fits well into the overall investment philosophy of Lord Abbett: a strong belief in active management; a commitment to making decisions based on fundamental research; a very healthy respect for risk management; a commitment to reinvest in the firm in terms of people, technology and support needed to produce consistently strong performance; and a commitment to building successful partnerships with their clients. She thanked the Board for its consideration, and asked if there were any questions.

MR. TRIVETTE said he assumed Lord Abbett had not had any major changes in staffing in this product in the last four or five years. MS. FOSTER said they had not, that the team has been very stable and growing.

MS. HARPER mentioned that the fee schedule was in the appendix and that Lord Abbett would offer a relationship discount based on the existing partnership with the ARMB in a domestic small cap account.

CHAIR SCHUBERT thanked them for the presentation.

MR. O'LEARY directed trustees to the page in the Callan manager search book that showed the exposure to different regional markets for all the candidates. He drew attention to the quarterly emerging markets exposure so that trustees could have a sense of the levels of exposure to emerging markets. He said Lord Abbett's exposure was the highest of the three finalists, and that was well below the benchmark exposure.

14(b). Mondrian Investment Partners Limited

Senior vice president in client services, TODD RITTENHOUSE, and DR. ORMALA KRISHNAN, senior portfolio manager, joined the meeting to present Mondrian's international small cap equity product for the Board's consideration. MR. RITTENHOUSE mentioned his and Dave Wakefield's existing relationship with the ARMB for the international fixed income portfolio that Mondrian manages. *[A copy of the slides used in Mondrian's presentation, plus backup information, are on file at the ARMB office.]*

MR. RITTENHOUSE gave a quick update on the independent organization, noting that all 51 investment professionals are based in London, and they have over $64 billion in assets under management - mostly for institutional investors. Mondrian has an equity plan for employees that is a great tool to motivate and retain the next generation at the firm. Currently, there are 80 equity holders, and no one person owns more than 10% of the equity. They use a value-oriented dividend discount methodology, which has been in place with the founding partners for over 20 years, and worldwide fundamental research is the hallmark of what they do. The open floor plan of the office in London facilitates communication within the individual groups and a sharing of ideas among the different groups. All the directors in the firm have investment responsibilities, except for John Emberson, who is the chief operating officer.

MR. RITTENHOUSE remarked that not many equity presentations talk about how important the fixed income process is to the equity process. All the work across the firm is done on real, inflation-adjusted terms, and the fixed income group does all the inflation forecasting and currency work.

MR. RITTENHOUSE also presented a representative client list and the business profile for the firm. Of the $64 billion under management, over $30 billion is for institutional investors, mostly for public pension funds. The asset types they manage are $20 billion in international and global fixed income, and about $28 billion in developed market equity (including $3.0 billion in international small cap). He said he was asked when Mondrian would be closing the international small cap equity product, and that would be when it reaches $4.0 billion in assets.

DR. KRISHNAN, the lead portfolio manager on the international small cap strategy, said she has been with the firm for ten years and has 17 years of investment experience in London as well as Singapore. The international small cap product has a dedicated team of four members, and they also rely on other teams within the organization for sector as well as country specialization knowledge. The small cap team is able to interact with the other teams within Mondrian because they use a consistent, inflation-adjusted dividend discount methodology across all the equity products.

DR. KRISHNAN stated that Mondrian is a value-oriented, defensive manager that believes the value of a company lies in its future income stream and that dividends represent the most tangible form of cash flow to a shareholder. Small cap is an asset class of more than 5,000 companies, and one really needs a systematic approach to evaluate the companies on a like-for-like basis. Rather than using something like a price-to-book multiple to look at a Japanese-related company and dividend yield to look at a U.K.-related company, the team at Mondrian makes use of the inflation-adjusted dividend discount methodology for all companies across countries and sectors.

Further, they make use of a consistent real discount rate for all companies across countries and sectors. Traditional managers would typically make use of long bond yields adjusted for some form of risk premium as the discount rate, but the small cap team tries to price risk explicitly at the stock level. They use scenario analysis, modeling base-case assumptions, as well as worst-case assumptions, to ascertain the range of outcomes. And particularly for this asset class, where stock-specific risk is much higher, they pay a lot of attention to the worst-case scenario as well as down-side risks.

DR. KRISHNAN said at Mondrian they define risk as the gap between the base-case return and the worst-case return, and they look for relatively low levels of that gap. They would typically have a higher position of a stock in the portfolio because of its minimized down-side risk.

DR. KRISHNAN said it might surprise people that Mondrian calls itself a value manager. But their objective is to deliver a target absolute real rate of return of at least 5% over a market cycle, and that is why they pay a lot of attention to the worst-case scenario, as well as on minimizing down-side risk. She displayed performance graphs from 1998 to March 2010 to illustrate Mondrian's value characteristics in bull and bear markets, which are protection on the down side and emphasis on up-side return. The performance was shown against the two most commonly used benchmarks, MSCI World ex-US Small Cap Index and the S&P Developed EX-US Small Cap Index. She said they are indifferent to the benchmarks, which is why they show their performance very transparently against both the indices. They have consistently outperformed during difficult or bear market periods, when the benchmark has been negative. Because they start on a higher base during the difficult market periods, they are not able to capture the full up-side during the bull market periods, but across the equity products at Mondrian they have captured at least 75% of the up side during bull markets. In the small cap product, they have been able to capture at least 90% of the up side.

DR. KRISHNAN stated that Mondrian's capital preservation during difficult market periods, without completely giving up on the up side, enables them to outperform their peers in the benchmark over the long run. They also show outperformance against the inflation index because they recognize that the liabilities of their clients are real in nature, and the assets that they manage have to meet those liabilities. So all their stock analysis is conducted on an inflation-adjusted basis.

DR. KRISHNAN showed a graph of the risk in Mondrian's international small cap portfolio, as measured by standard deviation, against the risk of the two major small cap indices. Their placement in the top left-hand quadrant shows consistent performance with minimized volatility. In another graph, she highlighted that Mondrian's fundamental analysis, value orientation, and focus on dividends have enabled them to achieve a successful track record of consistent low levels of volatility against their peer group.

DR. KRISHNAN stated that Mondrian's detailed, fundamental analysis consists of a comprehensive program of company visits, where they typically visit all the companies in the portfolio at least once a year at their location. In addition, among the four investment professionals in the international small cap group, they review another 100 companies: that is for idea generation to ensure that the alpha of the portfolio is kept alive.

Moving on to describe the framework for decision making, DR. KRISHNAN explained that the small cap asset class is a large universe of under-researched companies and is inefficient. The process all has to do with bottom-up stock picking, and Mondrian uses a 80/20 bottom-up/top-down allocation approach. Starting from the bottom, they use a quantitative tool to filter a more manageable list from the large universe of over 5,000 companies. This tool makes use of a multi-factor approach that uses company-specific variables that take into account risk and long-term sustainable growth, as opposed to the traditional P/Es and price-to-book, which are dependent upon the price factor in the numerator that is so often distorted by investor behavior.

Regarding the structure of the portfolio and deciding whether the existing stocks should remain in the portfolio or new stocks get added to the portfolio, DR. KRISHNAN said they use the best-case/worst-case model she spoke of earlier to evaluate the existing stocks. If they are looking at a new stock from the filtered list of stocks, they do a rigorous review of the company's balance sheet, income and cash flow quality, as well as look at the growth prospects of the industry and the competitive landscape in which a company operates. If they are satisfied with a company's financial strength and the long-term prospects of the industry, they proceed to stage two, which is typically a field trip to meet the management of the company, There, they try to understand the business operation, learn about costs, appraise the quality of the management, and understand management's attitude toward risk management and corporate governance. Stage three is using the assumptions for the key revenue drivers and key cost drivers to build a model to forecast the profit and loss statement, the balance sheet, and the cash flow to determine the long-term dividend-paying capability of the company. Those are then used as inputs into the dividend discount methodology.

Another layer in the decision-making framework is currency analysis. DR. KRISHNAN said that Mondrian does not make active currency overlay decisions, but they do take defensive currency hedging positions. They believe that currencies tend to adjust to their purchasing power parity over the long term, but they recognize that during the shorter term the currencies do fluctuate quite wildly above their purchasing power parity levels. So they will engage in a defensive hedging strategy if the currency is significantly overvalued by more than two standard deviations against its long-term purchasing power parity level. They do not engage in cross-hedging at all. The purpose of engaging in a defensive hedging strategy is to allow them to participate in stocks that may be attractive on their local real rate of return but that may not be attractive when converted to the U.S. dollar real rate of return.

DR. KRISHNAN reviewed Mondrian's sell discipline. One factor that can lead to a sell or trim is a price appreciation leading to a significant over-valuation of a stock. They would have to sell if the real rate of return fell below 5%, which is below their target minimum. Other factors to sell or trim would be a change in fundamentals affecting the long-term valuation of a stock, or because there are other attractive alternatives, or if a stock reaches its target market cap ceiling of $5.5 billion.

DR. KRISHNAN briefly reviewed the country allocation parameters for the international small cap portfolio. She said they have an overweight position in the U.K., France, Germany and Singapore, due to stock selection. There is a significant underweight position in Japan for macro reasons, as well as on stock selection. She also mentioned the value characteristics of the small cap portfolio, as measured by the P/E ratio and dividend yield. The portfolio turnover is roughly 25% — their detailed fundamental analysis ensures that the probability of negative surprises in the portfolio is very low, and that helps keep the turnover in check between 20% and 40%.

Having finished the formal presentation, DR. KRISHNAN inquired if there were any questions.

MR. TRIVETTE asked who were Mondrian's five largest clients in the international small cap equity product. MR. RITTENHOUSE replied that the largest was a sub-advisory relationship with Charles Schwab, which is a bit over $400 million, and the others were the Florida State Board of Administration, California State Teachers', the Nova Scotia Pension Authority, and Fresno City.

MR. RICHARDS asked if Mondrian picked stocks that were already paying a dividend or if they looked at stocks that they could help produce a dividend. DR. KRISHNAN stated that, as a result of their long-term approach in analyzing companies, about 95% of the portfolio consists of stocks with some form of progressive dividend policy.

As a follow-up, MR. RICHARDS asked if the 5% of the portfolio that is not producing a dividend was paying a dividend when Mondrian purchased those stocks. DR. KRISHNAN said no.

CHAIR SCHUBERT inquired if Mondrian offered a fee discount for multiple disciplines under management. DR. KRISHNAN replied that, apart from early funders like Charles Schwab and Florida that were given a discount, Mondrian has adopted a uniform approach with regard to fees for its other clients. MR. RITTENHOUSE added that the fee structure was provided in the written material, and he thought the Board would find it quite competitive.

CHAIR SCHUBERT thanked the people for their presentation and called a scheduled break from 10:14 a.m. until 10:27 a.m.

14(c). Schroder Investment Management

ANTHONY WILLIAMS, in charge of relationship management for the western states at Schroders, introduced MATTHEW DOBBS, the head of global small cap equities. *[For reference, a copy of the Schroder presentation slides is on file at the ARMB office.]*

MR. WILLIAMS stressed that asset management is all they do at Schroders, a 200-year-old organization. The Schroder family owns 47% of the equity, and employees own another 11%. The remaining equity is listed on the London Stock Exchange. Schroders has over $250 billion in assets under management around the world. The firm has $1.7 billion on its balance sheet to enable strategic growth, and no debt. The international small companies strategy was started in 1989 and has over $3.0 billion in assets. Schroders was one of the first managers to manage international small companies, and it has many public funds invested in the strategy.

MR. DOBBS reviewed the investment philosophy, saying that they seek growth and quality at a reasonable price. They do not believe that pure value is enough; they have to find companies that are growing faster than the average in the early stage of their development. They do not set a blind threshold for how much every company has to grow. Some of their most successful investments have been rather conservative investments, growing no more than low teens and with a decent dividend, undiscovered by investors. A company growing at about 11% a year with a 3% dividend yield that re-rates from eight times earnings to 12 times earnings can give a 35% compound return over five years. So there is no need to take tremendous risks on early stage biotech stocks or very risky poor balance sheets in this business.

MR. DOBBS said another aspect of quality is that Schroders carefully investigates company management. Small cap companies are extremely dependent on the key people running them. Visibility of earnings is very important, and they prefer to understand why a company can grow. Small cap is where they find companies exploiting small niches within what may be relatively mature economies. The final aspect of quality is a decent balance sheet: they have found that they get paid much better on the operational risk of a business but not on the balance sheet risk, so the portfolio typically has strong finance companies on average.

MR. DOBBS stated that what matters in small cap is not the growth that the small cap stock will offer but the price at which Schroders accesses that growth. They have a very disciplined approach to the valuation of fair value targets they set in the companies they buy. They also believe that stock selection is a primary source of value added, however, they do seek to add a bit of value through allocations between regions. They have no explicit part of the investment process that says they will buy a sector and hope to make money. The small cap area has relatively heterogeneous sectors; it has much more specific companies driven by their own local factors. The decision tree is stock, country, region, and finally sector — but they set the sector controls to make sure the portfolio does not have an unlooked-for sector risk. About 80% of the value comes from stock selection, and about 20% is from regional allocation.

MR. DOBBS said the long-term time horizon is an important part of the investment philosophy. Schroders is more comfortable at trying to assess what a company will look like in two, three or four years from now and discounting back to today to determine the fair value targets. This means they have relatively low turnover in the portfolio, typically 30% to 35%, and they own companies for three years, on average. It is a real advantage because [international] small cap stocks are often illiquid and difficult to trade, and they can lose a lot of added value through the frictional costs of trading. Schroders' trading platform, which strands through all the time zones, is one of the best in the business, but it is not their business to throw money at stock brokers on their clients' behalf.

MR. DOBBS reviewed Schroders' strong risk framework that allows them to see the risk throughout the portfolio in real time. He said the biggest risk that the portfolio managers obsess about as a team is the old-fashioned one of buying the wrong stocks. And the biggest risk control embedded in their process is the research they do themselves by direct contact with company management, and the way the portfolio is diversified in 200, and even up to 250, stocks to minimize stock-specific risk. Though that sounds like a lot of stocks, Schroders has achieved its returns with that level of diversification over many years. Even with 200 stocks, the benchmark coverage ratios for the active international small cap portfolio are generally in the order of 4%, 5%, 6%, so it is a very active stock-specific portfolio.

The final aspect of the investment philosophy is having a fully resourced and focused team whose primary role is the management of international small cap stocks. Different from large cap, they have to address the issue of limited liquidity with small cap, and they have to be more focused on the stock specifics. They are buying businesses and hoping to share in the excess growth and the better value of their in-price to create returns. MR. DOBBS said the presentation booklet included biographies so trustees could get a feel for the quality of the investment team. They are very experienced, and some of them have worked together for a considerable period of time. It is one of the biggest international small cap equity teams in the world, but they have $3.0 billion in dedicated, multi-regional, small cap assets to manage. He has been involved with the international small cap product since 1996, when he was the Pacific Basin specialist based in Singapore, and he took over the team lead role in 2000. One senior team member is based in Toyko, where his team is visiting companies and looking for good investments, and another member is based in Singapore. He and several others are based in London.

MR. DOBBS presented the investment process and highlighted three main elements: stock selection, the regional allocation portfolio construction, and risk management that feeds through the whole process. He said one of the great challenges but also one of the great opportunities of international small cap is the size of the opportunity set - 4,000 companies in the index, and probably 5,000 companies in this universe. He described the stock selection process that starts with quantitative screening to bring the universe down to 1,500 companies, which they regard as their potential investable universe. They then screen for growth, quality and value, and back-test those results, to get to a researched universe of 600 companies. That is when they concentrate efforts on direct company research and company visits. They may do three or four visits of companies they think could go into the portfolio, or may even visit competitors of companies. The focus is also on monitoring the 200-odd stocks that are already in the portfolio.

MR. DOBBS said all stocks are dependent upon the economic environment, and Schroders believes there are many companies in the small cap area that are benefitting from being in the right place at the right time. Schroders has plus or minus 7%

constraints in their regional locations, as part of risk control. Even in Japan in the 1990s, when stocks were expensive, Schroders had no problem finding lots of very attractive small cap stocks that were growing fast at mid- and low-teen multiples. Japan may have been a mature economy for the last 20 years, but until recently it was still the second biggest economy in the world with a lot of dynamic growth. Small caps can exploit fast-growing niches and adapt to dynamic changes much more than large caps can, because large caps tend to be more at the whim of the cycle because they are so big. Limited financing risk is also part of building stock portfolios: they tend to shy away from companies they think are very reliant or that have to raise new equity. They have to be that much more convinced by a business case if the company is going to have to raise equity in a market that may well be skeptical at times.

MR. DOBBS said another aspect of portfolio building is qualitative, and management assessment is very, very important to them. There is no business so good that bad management cannot destroy it. The management has to have an interest in shareholder value (prefer common stock, and do not like management incentivized by no-cost options that pay out big in three years), have a focused strategy (simple is good in small cap), have sound business practices, and have a historic record of success.

MR. DOBBS stated that two key things come out of research. One is a thorough understanding of the business, and the other is a fair value target for what the business will look like in three years. The fair value target is the first element into the decision to buy a stock, or determining if there is sufficient up side to leave a stock in the portfolio. That obviously becomes an important part of the sell discipline. As small cap stocks move up and achieve the fair value target, the portfolio managers siphon off the money from those names in the portfolio to put into smaller stocks that are less understood and where there is an inefficiency benefit.

MR. DOBBS said that the small cap portfolio managers have day-to-day responsibility for making stock choices in their regional areas, and they are assessed on that. But it is important to know that Schroders is not just bolting together four or five regional small cap portfolios. They want to take appropriate risks within each region to build up to the appropriate risk for the whole portfolio. The team must all feel identity with the portfolio, so they meet every week to discuss the portfolio and the region allocations. Changes are incremental over time and are not big moves.

MR. DOBBS said he sits on the Schroders Cyclical Market Forum and works very closely with Keith Wage, the chief economist with the region allocation teams. He provides more of the top-down view than a small cap specialist does, and actually, a lot of things that move money around in the Japanese economy are not top-down views - it's much more bottom-up. The Cyclical Market Forum looks at the small cap value targets across the closely researched universe to identify which regions and which sectors are offering the best value.

MR. DOBBS briefly mentioned the PRISM system, a powerful tool to help the portfolio management understand the risks they are taking in the whole portfolio. Each team member can also deconstruct the portfolio to look at the risks they are taking in their part of the whole portfolio. He reviewed the broad risk management guidelines: cash not to exceed 5% of the value of the fund; limits on stock weights, sector weights and country weights; and no use of derivatives.

In closing, MR. DOBBS pointed out that when looking at the risk characteristics of the portfolio Schroders looks like a blend with a slight growth bias. If they can buy better companies and faster-growing companies with valuations at least similar to or cheaper than the index, then they are doing what will make returns over the long term. When the portfolio characteristics are analyzed, the companies have better profitability and better financial characteristics than the index, but the growth is almost exactly the same value as the index. That means they are buying better companies for the same price as the index, and that is what can produce good returns.

MR. DOBBS said that Schroders seeks to provide clients a genuine, developed international small cap portfolio. They invest in emerging companies, not emerging countries. The S&P EPAC Small Cap Index includes Korea, so Schroders invests in Korea; but even including Korea, this portfolio's exposure to emerging countries over long periods has been less than 5%. Where they do have the leeway to invest in emerging markets, they do so in a very select number of markets — because they do not think they should be taking a macro risk in emerging markets and pretending it is a small cap risk. Schroders believes there are relatively few emerging markets that have genuine small cap opportunities, and that goes to the big sectors in small cap being industrials and consumer discretionary. The development of transport and consumer retailing are very interesting sectors in emerging markets, but they see little point in buying a small cap Brazilian bank, for example, because the large cap Brazilian banks have all the cards. A lot of emerging markets are dominated by raw materials and mining companies, and Schroders does not invest in mining in international small cap.

TRUSTEE MIKE WILLIAMS referred to Schroders' statement that there is no use of derivatives in the international small cap portfolio. He asked if that meant that Schroders did not use any hedging feature to protect against currency risk.

MR. DOBBS said it might be a slight definitional point about what a derivative is, but they have used foreign exchange contracts in the past. The last time was around 2002, when they actually hedged the Japanese yen back into the dollar, which was a profitable trade. But, by and large, they expect to take the currency positioning as part of the underlying stock positioning and as part of the portfolio. The details of how to deal with currency is something that Schroders could work out in would probably be a separate mandate with ARMB.

MR. O'LEARY requested some history on how long it had been since Schroders had more than 200 stocks in its international small cap portfolio.

MR. DOBBS replied that they have always had more than 200 stocks in the portfolio. He said that as they add assets under management in international small cap they lose a bit of flexibility. But what they gain, particularly with Schroders' investment process of low turnover and a well-diversified portfolio, is the ability to retain a tremendous basin for the people and talent that the firm can afford to have. He commented that a very active international small cap manager may add value, but there is the threat that if they get it wrong it removes the reason a fund went into small cap in the first place. Schroders is not a high risk, high return manager, but the way they manage small cap has been very well accepted by a wide client base in the U.S.

MR. O'LEARY mentioned that Schroders has a history of closing products, and asked what size would cause them to close the international small cap fund. MR. DOBBS responded that an additional closing would be $1.0 billion from here [$3.0 billion in assets], but they would accommodate existing clients first, so new business would be about $600 million.

MR. PIHL noted that returns were provided on a calendar year basis through 2008 and also for the latest one-year period. He inquired about the calendar year 2009 return, as well as the 2010 year-to-date return.

MR. DOBBS said he did not have the number off the top of his head. Schroders provided the 2008 return for the international small cap fund composite because that is a number that has to go through the auditing process; the 2009 return [for the small cap composite return] is just being audited now.

MR. O'LEARY stated that the 2009 return was 49.29%, gross of fees. He added that Callan had provided a page of more recent performance in its materials.

There being no further questions, CHAIR SCHUBERT thanked the gentlemen from Schroders for their presentation.

14(d). Board Discussion and Selection of Two International Small Cap Managers

CHAIR SCHUBERT opened the floor for discussion.

MR. PIHL said he had a couple of observations: Schroders seemed to have far lower management fees, judging from the difference between gross and net returns; Mondrian's performance was clearly superior, looking at year-to-year numbers over the last five years; the protection in down periods that Mondrian emphasized was evident in

2008 and 2009 returns; and Lord Abbett's and Mondrian's fees were quite similar.

CHAIR SCHUBERT floated the idea of possibly being able to exclude one manager. She said she found the Lord Abbett presentation hard to follow, and in Callan's material it looked like the firm had not performed well in the last two years. She asked Mr. O'Leary for his comments on that.

MR. O'LEARY responded that the Chair had correctly identified that Lord Abbett was the most volatile of the three managers. Therefore, given the market environment of the last couple of years, their performance was understandable but accurately depicted by the Chair.

CHAIR SCHUBERT said she liked Mondrian's focus on minimizing the down-side risk and that they try to get an absolute real return of 5% or greater.

MR. TRIVETTE said he, too, saw the same thing in terms of the down-side risk with Mondrian. He also made note of Schroders' lower risks and lower fees. So he was leaning toward those two managers at this point.

MS. ERCHINGER indicated that she agreed with the trustee comments made so far. She thought that Mondrian did an exceptional job of explaining their entire process and giving the Board comfort on how they mitigate the down-side risk. Further, Mondrian's fees appeared to be lower than Lord Abbett's. Given the performance of Lord Abbett's portfolio, she was leaning in the same direction as the Chair and Trustee Trivette.

CHAIR SCHUBERT sought input from the chief investment officer.

MR. BADER stated that Mondrian has distinguished itself as the best in class in international small cap, and he expected that that might be the Board's view. He said that when it gets to the question of which manager would complement Mondrian, it is a tighter call. He did not advise basing the decision completely on fees, because what the Board saw was simply Lord Abbett's proposal and not the terms of a contract the ARMB might enter into with them. Lord Abbett had indicated in their presentation that the fee was not what the ARMB would get. The staff sort of looked at Lord Abbett as a better complement to Mondrian, but certainly Schroders would be a complement as well. Lord Abbett tends to be a little growthier over the long term, whereas Mondrian has more of a core style. He concluded by saying that staff would be comfortable with the wisdom of the Board on whatever managers they chose.

CHAIR SCHUBERT recalled that Schroders described themselves as a blend with a slight growth bias.

MR. BADER said initially in the presentation Schroders talked about the small cap portfolio being growth. While they do tilt toward growth, staff's and Callan's evaluation of the managers over the long term showed that Schroders is closer to a core manager. That was why staff felt that Lord Abbett was a better complement to Mondrian.

DR. JENNINGS first disclosed that Schroders was a sub-advisor in a Vanguard product that he was invested in, so he was a bit familiar with that longer term. He said he came in during conversations yesterday biased towards Schroders and Mondrian, but he was comfortable that any of the manager combinations were appropriate. Nothing he saw in today's presentations moved him off his Schroders-Mondrian bias.

DR. JENNINGS pointed out two factoids that jumped out from the presentations. He found the shorter [return] history at Lord Abbett to be particularly striking: 2005 is not a long time ago for the international small cap product to have started. The other element of interest was that Lord Abbett owns Schroders as their third largest holding. Obviously, that was the whole firm and so a little bit different, but it was a small endorsement between the two managers.

MS. ERCHINGER remarked that the Board has talked before about the impact on the ARMB's investment staff of adding additional managers. She asked Mr. Bader if he was concerned at all about that or if the impact would be minimal.

MR. BADER replied that an additional manager would have an impact but it would be minimal.

CHAIR SCHUBERT asked if the trustees were ready to make a motion.

MR. PIHL said he would like to pick one manager at a time, starting with Mondrian because it seemed to be a clear choice among trustees.

<u>MR. PIHL moved that the Alaska Retirement Management Board select Mondrian Investment Partners Limited as the first international small cap equity investment manager to invest up to $100 million, and direct staff to enter into an investment contract with Mondrian, subject to successful contract and fee negotiations</u>. <u>MR. TRIVETTE seconded</u>.

COMMISSIONER KREITZER stated her intention to abstain from voting because she was not present to hear all three presentations.

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

The motion passed unanimously, 7-0.

MS. HARBO moved that the Alaska Retirement Management Board select Schroder Investment Management as the second international small cap equity investment manager to invest up to $100 million, and direct staff to enter into an investment contract with Schroders, subject to successful contract and fee negotiations. MR. PIHL seconded.

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

The motion passed unanimously, 7-0.

15. Contribution Rates for FY2012

MR. SHIER requested and was granted a brief at-ease while staff distributed some additional documents that he and others had prepared late yesterday, assisted by the Board's legal counsel, and with Buck Consultants also checking the new language *[on file at the ARMB office]*.

Resolution 2010-09:

MR. SHIER said that following the Board's discussion with Buck Consultants his staff revised the cover memo for the FY12 contribution rate resolutions to say that the State is paying more than simply the difference in the statutory rate and the rate that will be set today times the payroll. In addition to that mathematical calculation, the State will also pay $57.6 million in PERS and $20.9 million in TRS. He said this circumstance will continue as long as there is a system wherein the statutory rate and the actuarial rate attributable to employers is a simple mathematical rate that does not include the additional percentage that the State would have to contribute as the percentage of total payroll.

MR. SHIER said Mr. Bader had informed him that David Teal from Legislative Finance would be attending the September board meeting, when there would be further discussions about rate setting, in light of the effect that will exist for years to come.

Starting with Resolution 2010-09, MR. SHIER reviewed the new language in the June 24, 2010 cover memo for the FY12 PERS Employer Contribution Rate Tier I-III, second page and the end of the second paragraph, where he had added, "..., the State will also pay an amount equal to the Defined Contribution Retirement Plan employer contribution rate times the estimated Defined Contribution Retirement Plan payroll, as calculated by Buck Consultants." He said this made it clear in the ARMB documentation a practice that was accomplished last year after the rate setting by asking Buck Consultants to calculate that amount for the Division of Retirement and Benefits so that the Department of Administration could transmit that information to the Office of Management and Budget in the Governor's Office. Those amounts are in the budget for the year starting July 1, and those amounts will flow through to the trust funds. The revised language was to make clear that the State is accomplishing that contribution.

MR. SHIER recommended that the Board adopt Resolution 2010-09.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board set fiscal year 2012 PERS actuarially determined contribution rates attributable to employers, consistent with its fiduciary duty, as set out in the attached form of Resolution 2010-09. MS. HARBO seconded.

MR. TRIVETTE asked if the change in the wording of the June 24 memorandum affected the wording of the resolution. CHAIR SCHUBERT said no.

Referring to slide 13 in Buck Consultants' presentation yesterday, MR. RICHARDS sought confirmation that the revised memo language that Mr. Shier just read did not change the additional State contribution amounts for FY12 that Buck presented. He voiced his concern about the State's assistance amount rising to $1.3 billion in 2029, as Ms. Erchinger pointed out yesterday.

MR. SHIER confirmed that the total State assistance amount was scheduled to be $477.1 million for FY12. The revised memo just made it clear on how that amount was arrived at.

When MS. ERCHINGER requested clarification that Resolution 2010-09 for PERS remained unchanged, MR. SHIER assured her that the change to the cover memo was to clarify that the amount the State was going to contribute on behalf [of employers] would include an additional percentage and not simply be the difference between the rates. There is an additional contribution that the State will make this year and next year. He added that after discussion with Mr. Teal in September, the Board may deliberate further and decide that it benefits member employers to have Buck Consultants essentially set the contribution rate so that a simple mathematical differentiation can be made to arrive at the proper State contribution.

MR. PIHL asked if there was any way to address the question about the true-up between estimated payrolls used and what turns out to be the actual payrolls [because of the plus or minus it causes in Buck's calculation of the State's assistance].

MR. SHIER indicated there were a number of considerations that he could not answer adequately at the meeting. He said there are other entities that would have an interest in that question, including the Legislature and the Department of Law. One concern is what would happen if the actual payroll was less than the estimated payroll: would the surplus State assistance contribution lapse back into the general fund?

MR. PIHL said he thought the true-up would be either added to or deducted from the following year's State assistance contribution.

MR. SHIER said he would be happy to organize a presentation on that with the Department [of Administration].

COMMISSIONER KREITZER informed fellow trustees that she had been briefed by Ms. Petro and Mr. Shier about yesterday's discussion on this subject. She was thinking of walking through with the Department of Law what the concerns and barriers might be, because the true-up idea sounds simple, but nothing is ever simple. She offered to touch base individually with the trustees who had expressed an interest in this topic, as well as anyone else who was interested, to make sure she understood their perspectives and conveyed the whole picture to the Department of Law. She would respond to all the Board members, at least in the form of email, to inform them of what she learned and what the possible barriers are, and then see if it was something the Board wanted on the next agenda for further discussion.

MR. JOHNSON said that it would be an appropriate discussion to have, if the Board so desired it. He added that at its September meeting the Board might want to consider either a new resolution that provided specifically for that or an amendment to this particular resolution so that it was all in one place. It was a bit premature to start crafting that language now though.

MS. ERCHINGER asked Mr. Johnson, in his understanding of state statute that the Board was supposed to establish a contribution rate, if it appeared that it would be appropriate for the Board to not only establish a rate, such as it is in resolution, but to also request an additional dollar amount that would be equal to the difference between what the estimated payroll costs were and last year's rate applied against the estimated payroll versus the true-up at year end and that is still within the requirements of statute, or if the Board was required to request that Buck convert that into a contribution rate so that the Board was simply passing a rate.

MR. JOHNSON said it was worthy of discussion and analysis, but he could not comfortably give an opinion at this time. He agreed with the Commissioner that it requires a Department of Law interpretation possibly of provisions in AS 39.35.280 as it relates to PERS. It would be premature to craft any language at this point.

COMMISSIONER KREITZER said she had had many conversations with the Department of Law about many of these issues, which may appear to be simple on the face. These actions are important, and she wanted to make sure that everyone knew the basis upon which they were making decisions. That is why she planned to bring the trustee questions to the Department of Law for clarification.

MR. JOHNSON stated that, in addition to the statutory language, there might be some legislative history on that point as to what the Legislature intended, and he did not have that history at hand to assist in this analysis.

MR. TRIVETTE said he would appreciate Mr. Johnson and Mike Barnhill in the Department of Law, or whomever, to look at that by the September meeting. He also wanted to voice the same concern that Mr. Pihl has raised for years about the $1.3 billion in additional State contribution [projected in 2029]. He wanted to be able to discuss that at the September board meeting.

MS. ERCHINGER asked if would be appropriate to postpone action on Resolution 2010-09 so it could be brought back up at the September meeting with potential changes.

COMMISSIONER KREITZER recommended proceeding with action on the resolution, because if the Board has identified reasons to amend it, then it will amend the language at the September meeting. Otherwise, the Board has other business in September. If there is language to amend the resolution in September, the Division of Retirement and Benefits would get that out to trustees early enough so they have an opportunity to review it ahead of time.

MR. PIHL made it clear that the Board was not talking about amending the contribution rate but about amending the payroll dollars that the rate applies to and a calculation. He did not see any need to defer the motion.

MS. ERCHINGER said the rate setting was one of the two most important decisions the Board makes each year. She thought that getting the valuation analysis from Buck at the April meeting was the first time that some of the trustees had really seen the magnitude of the difference between what the State's on-behalf-of payment is going to be now and what it is going to be in the future. She could not let the opportunity pass to say that the Board was setting the rates at this meeting based on the best information that it has had up until now. But, given what she saw coming in the future, she hoped there would be discussion, beyond the standard valuation discussion, about perhaps a new assumption that has not been talked about in the past. The Board talks what the salary increase is going to be, which is not a small assumption in terms of the overall impact on contribution requirements down the road, but it is a small assumption relative to the assumption the Board is making when it looks at graphs that say the State will be paying an additional $336 million in FY10 on behalf of the unfunded liability, and that number is going to be $1.3 billion in 2029.

MS. ERCHINGER wondered what assumption the Board was looking at that says trustees have a role as fiduciaries to make sure that that amount can get paid in the future. Certainly, the Legislature has the biggest role to play in that, and the ARMB's role is just to make sure that the retirement system is fully funded. But given that the state's oil production is declining each year so that revenues will decline in the future, and that the [additional State contribution] is rising astronomically, she hoped that the Board would consider creating something like a sustainability committee that would examine Buck's projection graphs and perhaps come up with some other way of setting rates in the future that would address this issue, maybe so the Legislature would at least know that the Board has a serious concern about the level of [State] funding going into the system today versus what is going to be required 20 years from now.

CHAIR SCHUBERT asked for a roll call on the motion.

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

The motion passed unanimously, 8-0. *[Commissioner Galvin was absent.]*

Resolutions 2010-10 and 2010-11:
MR. SHIER drew attention to the action memo titled "FY2012 PERS Retiree Major Medical Insurance and Occupational Death & Disability Benefit Rates," attached to Resolutions 2010-10 and 2010-11. He recommended Board adoption of those resolutions.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board set fiscal year 2012 PERS Retiree Major Medical Insurance and Occupational Death & Disability benefit rates as set out in the following resolutions:
(1) Resolution 2010-10: Public Employees' Defined Contribution Retirement Plan Retiree Major Medical Insurance Rate; and
(2) Resolution 2010-11: Public Employees' Defined Contribution Retirement Plan Occupational Death & Disability Benefit Rate.
MS. HARBO seconded.

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

The motion passed unanimously, 8-0. *[Commissioner Galvin was absent.]*

Resolution 2010-12:
MR. SHIER presented a replacement June 24, 2010 action memo for the one in the

packet, which reflected additional language at the end of the second paragraph of page two: "..., the State will also pay an amount equal to the Defined Contribution Retirement Plan employer contribution rate times the estimated Defined Contribution Retirement Plan payroll, as calculated by Buck Consultants." He recommended adoption of the resolution, with that clarifying language added in the cover memorandum.

<u>COMMISSIONER KREITZER moved that the Alaska Retirement Management Board set fiscal year 2012 TRS actuarially determined contribution rates attributable to employers, consistent with its fiduciary duty, as set out in the attached form of Resolution 2010-12</u>. <u>MS. HARBO seconded</u>.

MR. TRIVETTE sought and receive clarification from the Chair that the resolution language remained unchanged and that it was only the cover memo that had been revised.

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

The motion carried unanimously, 8-0. *[Commissioner Galvin was absent.]*

Resolutions 2010-13 and 2010-14:
MR. SHIER drew attention to the action memo titled "FY2012 TRS Retiree Major Medical Insurance and Occupational Death & Disability Benefit Rates," attached to Resolutions 2010-13 and 2010-14. He recommended Board adoption of those resolutions.

<u>COMMISSIONER KREITZER moved that the Alaska Retirement Management Board set fiscal year 2012 TRS Retiree Major Medical Insurance and Occupational Death & Disability benefit rates as set out in the following resolutions:</u>
<u>(1) Resolution 2010-13: Teachers' Defined Contribution Retirement Plan Retiree Major Medical Insurance Rate; and</u>
<u>(2) Resolution 2010-14: Teachers' Defined Contribution Retirement Plan Occupational Death & Disability Benefit Rate</u>.
<u>Seconded by MS. HARBO</u>.

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

The motion passed unanimously, 8-0. *[Commissioner Galvin was absent.]*

MR. SHIER said that concluded the Board actions on FY12 contribution rates.

MR. BADER stated that Mr. Teal had been invited to the September Audit Committee meeting in Fairbanks, not the Board meeting. It was thought to be a better forum to get into a deeper discussion, but the Board could invite his participation at the board meeting, if it wished.

16. Investment Actions:
Resolution 2010-15 - Delegation of Procurement Authority

MR. BADER stated that at its April meeting the Board adopted Resolution 2010-08, procurement-related delegation pursuant to 15 AAC 112.230, which authorizes the Board to delegate in writing its authority under the procurement regulations to a public official. During that discussion, trustees had questions regarding how far that authority extended; such that did it cover investment manager selection or terminations, consultant terminations in the Investment Advisory Council, etc. The Board passed the resolution, in order for staff to proceed with upcoming contract negotiations, with the understanding that staff would return at the next meeting and provide clarifying language to that delegation.

MR. BADER said that Resolution 2010-15 does not refer to the Board's authority to contract for investment, custodial, or depository powers or duties, or to appoint members of the Investment Advisory Council. Those are appointments of the Board that are not subject to the procurement code and, therefore, they are not mentioned in the resolution. The Board retains its authority to make those appointments, notwithstanding this delegation.

MR. BADER said there had also been a question about whether the delegation should be made to office holders or appointees by name or by the position that they hold. The Board, at the April meeting, seemed to prefer that the delegation be to the position, not to a named individual. He asked the Board to approve the delegation of procurement-related authority by resolution.

<u>MR. TRIVETTE moved adoption of Resolution 2010-15 delegating to the Department of Revenue Deputy Commissioner, Chief Investment Officer, State Comptroller, and Board Liaison Officer certain powers noted in the *Delegation of Procurement-Related Authority* attached thereto</u>. <u>Seconded by MR. WILLIAMS</u>.

MR. TRIVETTE remarked that the new resolution did not make any changes but clarified exactly what the Board had asked staff to do. He said Mr. Bader made things very clear in his comments, and he urged everyone to vote in favor.

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

MR. BADER reported that the contract with IFS (Independent Fiduciary Services) was signed and sent to the Chair for signature, after a lengthy process and the work of attorneys to reach that point.

MR. TRIVETTE said he guessed the September meeting was too early to get the [unnamed] report that should have been presented at the April meeting. MR. BADER said it would be at the December meeting.

UNFINISHED BUSINESS

1. Calendar

MS. HALL reported the addition of an Audit Committee meeting on October 19, otherwise, the 2010 calendar remained unchanged. She indicated that a proposed meeting calendar for 2011 was included in the packet. Lastly, she and Mr. Bader had confirmed October 7-8 date for the Education Conference and had made the hotel arrangements.

MR. PIHL asked if the September 9 and 22 committee meetings could be brought together, and MS. HALL explained why the Budget Committee has to meet early enough that staff can accomplish any changes before the budget is presented to the Board at its September 23-24 meeting.

<u>MS. HARBO moved to adopt the ARMB meeting calendar for 2011, as presented</u>. <u>COMMISSIONER KREITZER seconded</u>. The motion passed unanimously, 8-0.

2. Disclosure Reports

MS. HALL indicated that the financial disclosure report was included in the meeting packet, and there was nothing unusual to report.

3. Legal Report

MR. JOHNSON reported on two knock-on effects of the Mercer settlement with the State of which he wanted the trustees to be aware. One related to Deputy Commissioner Petro's report yesterday on the status of the identity theft protection matter that arose as a result of the PriceWaterhouse and Equifax process. The link to Mercer was that the [personal] information was part of the discovery in that case. He attended a bar association meeting on the issue of identity theft in Alaska and learned about the provisions in Alaska on that subject. The new acting deputy attorney general, Ed Sniffen, reported on the PriceWaterhouse matter and stated that the settlement with them was probably state of the art for the whole issue and the whole industry of protecting folks against identity theft, and that the period of time for ongoing disclosure protection was at least twice as long as any previous settlement that had been reached with a party that had inappropriately disclosed information. Mr. Sniffen also reported, as the deputy commissioner did yesterday, that there have been no claims of identity theft attributable to this process.

MR. JOHNSON said he spoke briefly at the Audit Committee about the issue of how the settlement money in the Mercer case will be allocated between the PERS and TRS trust funds, and this topic will be presented to the Board at the September meeting, if not before that. He said there is a range of potential advice on what that allocation might be, and he urged the Board to engage in a deliberative process and to carefully consider what is presented. He had no recommendation at this time. He said the issue about the funds coming into the State before the allocation decision has been made is something that warrants further discussion with Ms. Leary and her staff to make sure it is all doable.

MR. JOHNSON listed his other activities as being involved in additional investments the Board made, and being indirectly engaged with respect to some of the litigation that has faced the Board.

COMMISSIONER KREITZER stated that she did not think it was necessary for the Board to wait until the September board meeting to decide on allocating the Mercer settlement money, that it could be done at a special teleconference meeting.

NEW BUSINESS - None.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS - None.

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. JENNINGS reminded the Board of a February 2006 presentation they heard by LaSalle to invest $30 million in a medical office portfolio. At the time, his IAC comments were a reaction to the $30 million threshold, which was less than a third of one percent of the portfolio at the time. He had tried to stress that there is a difference between the governing fiduciary role and a managing fiduciary role. After that $30 million presentation, the Board moved to adopt some thresholds of $50 million and $100 million for delegation [of authority] to staff and bolted into place what he thought was a good process.

DR. JENNINGS said the quality of yesterday's presentations by Angelo Gordon and Warburg Pincus highlighted that the Board's process for delegation to staff is working well, and those investments happened at inopportune times because of where the market was then. The process has had time to run, and what the trustees saw yesterday should increase their confidence in the process. It would not necessarily lead to increasing the delegation thresholds, but the Board should congratulate itself on the fiduciary oversight and just moving toward the separation of the two roles, the governing fiduciary versus the managing fiduciary. It merits some informal conversation among the trustees about whether they are comfortable with not necessarily seeing [the investments]. The Board heard that there are some new investments that staff made under that process recently that are going well. He thought that the smaller investments did not necessarily need to come to the Board, and that there is a good process in place.

TRUSTEE COMMENTS

MR. PIHL suggested that at least annually it would be a good idea to include in the meeting packet a copy of the statute that created this board. It would be helpful to see the clear charge in statute as the Board addresses the unfunded liability.

CHAIR SCHUBERT reported that the ARMB invited the Alaska Permanent Fund Board and the University of Alaska Board to the education conference in October, because it makes for a good discussion to have everyone there. She thanked Mr. Johnson for his role in the Mercer litigation, saying that she had neglected to include his name in her earlier comments.

MR. TRIVETTE suggested preparing an action list to keep track of promises or requests that occur during meetings so that things do not fall through the cracks. He is involved in other groups that use that process quite successfully to keep track of things, and so he recommended it.

MS. HARBO thanked the Division of Retirement and Benefits and Teresa Kesey for taking the time to answer her questions on the CAFRs.

MS. ERCHINGER said she also wanted to thank the Department of Administration. A lot of questions have come up surrounding how things are computed, and while it is very complicated and complex, the department has been very patient in trying to get the information the Board needs to make good decisions.

Regarding her earlier comments about future rate setting, MS. ERCHINGER said she thought it would be worth considering establishing a committee to look into the sustainability issue of the long-term plan for setting contribution rates. She wondered if the Board had the ability to hold a work session, where trustees would be able to share ideas about the unfunded liability and its role in a less formal setting. She has tried to read the meeting minutes to see what transpired in discussions, but the Open Meetings Act makes it difficult to converse among the Board members to figure out what was talked about, what was not talked about, and what people were thinking. Something of this magnitude really warrants a good understanding from other people around the table as to what they have considered in the past.

COMMISSIONER KREITZER said that was an excellent suggestion. She offered, depending on the Chair's consent, to put together a potential agenda (that would include going through the Board's responsibilities) for Ms. Erchinger to look at and then pass it on to the Chair for possibly scheduling a work session. She stated that since she became commissioner the department has tried to find ways to present information in a simple way, but when the conversation changes slightly, some of the graphs are not the best graphs to look at from that different perspective. So they find themselves running all kinds of scenarios. One example was the pension obligation bond discussion, and there were all kinds of scenarios for that. She has gone back to look at some of those things because they remain helpful going forward. Any ideas that trustees have for different ways to present information, or if the department is not showing information that people would like to see, they would be happy to take another look at that. She wanted to make sure the department was meeting its statutory obligations of what it is required to present to the Board, but they would be happy to do it in a different fashion, too.

MR. TRIVETTE expressed support for Ms. Erchinger's comments. He said the ARMB is responsible for $18 billion of money. Most organizations that he has been a part of long term hold at least one meeting a year to discuss issues and to look back at where they have been and to look forward at where they want to be. He supported having a half day out a regular meeting or to meet at a separate time, depending on how it worked best for staff and trustees. Organizations that spend time to do that tend to run smoother and to get a lot further a lot faster.

MR. JOHNSON mentioned, as a point of history, that earlier on in the Murkowski administration the PERS and TRS boards, which had rate setting responsibilities at that time, held a work session in Girdwood to go over issues with the then-actuary, Mercer. Some of that discussion made it into discovery on some recent litigation. He thought it was a worthwhile session and that it seemed to be very valuable to everybody involved. He did not recall an analogous work session like that since then.

FUTURE AGENDA ITEMS

Items were discussed throughout the meeting.

ADJOURNMENT

There being no objection and no further business to come before the board, the meeting was adjourned at 11:56 a.m. on June 24 2010, on a motion made by Ms. Harbo and seconded by Mr. Richards.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Gayle Harbo

Corporate Secretary

Note: Accu-Type Depositions recorded and prepared a written transcript of the meeting, and Confidential Office Services prepared the summary minutes. For in-depth discussion and more presentation details, please refer to the recording of the meeting and presentation materials on file at the ARMB office.

Confidential Office Services
Karen Pearce Brown
Juneau, Alaska