State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

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

MINUTES OF
December 2-3, 2010

Thursday, December 2, 2010

CALL TO ORDER

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

ROLL CALL

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

ARMB Board Members Present
Gail Schubert, *Chair* (Dec. 3)
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Kristin Erchinger
Commissioner Patrick Galvin (Dec. 2)
Commissioner Annette Kreitzer
Martin Pihl
Tom Richards
Mike Williams

ARMB Board Members Absent
Gail Schubert on Dec. 2 and Commissioner Galvin on Dec. 3

Investment Advisory Council Members Present
Dr. William Jennings

Department of Revenue Staff Present
Jerry Burnett, Deputy Commissioner

Gary M. Bader, Chief Investment Officer
Pamela Leary, State Comptroller
Bob Mitchell, Senior Investment Officer
Ryan Bigelow, State Investment Officer
Zach Hanna, State Investment Officer
Scott Jones, Assistant State Comptroller
Judy Hall, Board Liaison Officer

Department of Administration Staff Present
Kevin Brooks, Deputy Commissioner
Patrick Shier, Director, Division of Retirement and Benefits

Consultants, Invited Participants, and Others Present
Robert Johnson, ARMB legal counsel
Michael O'Leary, Callan Associates, Inc.
Gary Robertson, Callan Associates, Inc.
Michael Hayhurst, KPMG
Corrine Fiedler, KPMG
Steven Harding, Independent Fiduciary Services
Barbra Byington, Independent Fiduciary Services
John Reinsberg, Lazard Asset Management
Tony Dote, Lazard Asset Management
Blair Thomas, TCW Energy Group
Claudia Schloss, TCW Energy Group
Glenn Carlson, Brandes Investment Partners
Juan Benito, Brandes Investment Partners
Lynn Blake, State Street Global Advisors
Eric Brandhorst, State Street Global Advisors
Neil Tremblay, State Street Global Advisors
John Alcantra, NEA Alaska
Peggy Wilcox, APEA/AFT
Jack Kreinheder, Office of Management & Budget *(by telephone)*

PUBLIC MEETING NOTICE

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

APPROVAL OF AGENDA

The report of the Special Committee on Actuarial Issues was moved to Friday afternoon to follow #19 - Actuarial Valuation Assumption Changes.

MS. HARBO moved to approve the agenda. COMMISSIONER KREITZER seconded the motion. The agenda was approved as amended.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

COMMISSIONER KREITZER said December 6 would be her last day as commissioner, and she wished to recognize Deputy Commissioner Rachael Petro for all her work on behalf of the ARM Board.

MARTIN CROWLEY spoke by teleconference and asked how he could find out the current return on the State Street Institutional Treasury Money Market Fund, which he invested in through the State of Alaska Supplemental Benefit System (SBS) and Deferred Compensation Plan. MR. BADER gave him phone numbers to call him or Ryan Bigelow directly.

APPROVAL OF MINUTES

MS. HARBO moved to approve the minutes of the August 16, 2010 meeting as presented. MS. ERCHINGER seconded the motion. The motion passed without objection.

ELECTION OF OFFICERS

MS. HARBO moved to nominate Gail Schubert as chair. MR. PIHL seconded. There were no other nominations, and Ms. Schubert was elected chair for one year by unanimous consent.

MS. HARBO moved to nominate Sam Trivette as vice chair. MR. PIHL seconded. There were no other nominations, and Mr. Trivette was elected vice chair by unanimous consent.

MR. WILLIAMS moved to nominate Gayle Harbo as secretary. MR. RICHARDS seconded. There were no other nominations, and Ms. Harbo was elected board secretary for another year by unanimous consent.

REPORTS

1. Chair Report - None.

2. Committee Reports

2(a). Audit Committee

Committee chair MARTIN PIHL reported on the committee's December 1 meeting, at which KPMG provided the final audit results for both the Treasury Division and the Division of Retirement and Benefits. He said KPMG was scheduled to give a report to the full board at this meeting. The committee also received a report from Mr. Shier on progress in the employer audit program. *[The minutes of the December 1, 2010 committee meeting are on file at the ARMB office.]*

3. Retirement & Benefits Division Report

3(a). Membership Statistics

The quarterly and cumulative reports of membership statistics for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) were included in the meeting packet.

VICE CHAIR TRIVETTE asked if the next cumulative report could include a column for the number of actives in PERS and TRS. MR. SHIER said he could do that.

MS. HARBO had a question about how to reconcile the number of defined contribution plan people who terminated as reported in the September report with the number in the June report. She added that it looked like the turnover was about 38%, and she wondered if that was accurate.

MR. SHIER said he would work on reconciling those numbers.

MS. HARBO requested additional information on the dollar amount withdrawn by employees who have terminated over the last four years. MR. SHIER said that a PERS employee who terminated after two years would take 25% of the employer contribution with them, and the remaining 75% of the employer contribution would stay in the defined contribution plan fund for that employer.

MR. PIHL mentioned that the Board requested the membership statistics during a transition period to the new defined contribution plans, and he questioned if that information was still useful or needed four years later.

COMMISSIONER KREITZER said it was a good idea for the Board to re-examine the information it wanted to see, because it takes staff time to collect the data and prepare the reports, and maybe there were other things trustees would be more interested in seeing now.

MS. HARBO said it should be one of the points the Board talks about at a work session. She said Ms. Erchinger raised the point at the Audit Committee meeting about the cost to employers when people terminate, and it illustrates the point that it is important to have the information to make sure the retirement systems are working for the members.

3(b). Buck Consulting Invoices

The regular report of invoices from Buck Consultants was included in the meeting packet.

4. Treasury Division Report

Department of Revenue Deputy Commissioner JERRY BURNETT said he was asked to comment on an article run by the *Associated Press* that the State of Alaska was going to have a $5.0 billion annual budget surplus this year and next year. He said he spoke to the reporter at *AP*, and there was a correction in the paper. The State of Alaska has a general fund projected surplus this year, and a reporter mistakenly took that to be a budgetary surplus. The budgetary surplus is in the tens of millions of dollars this year, or possibly hundreds of millions of dollars, but not in the billions of dollars.

5. Chief Investment Officer Report

Chief Investment Officer GARY BADER referred to the written report in the packet. The first two items were correspondence from two labor organizations regarding the management practices of specific companies and asking the ARMB to take some action. He said it has long been the practice of the Board to not get involved in issues of economically targeted investing or to take social or political points of view. He recommended taking no action.

VICE CHAIR TRIVETTE suggested that staff provide the trustees with copies of the correspondence by regular mail, and anyone who wished to comment further could do so. He felt that it would relieve staff from a fiduciary standpoint. MR. BADER indicated he would follow that up.

MR. BADER reviewed a list of rebalancings and transfers that staff completed since the last board meeting. He also recommended removing Crestline Investors from the watch list, where they had been placed a year ago because of an acquisition that potentially could have diverted their attention from managing the ARMB's portfolio.

<u>MS. HARBO moved that the ARMB remove Crestline Investors from the manager watch list</u>. <u>MS. ERCHINGER seconded the motion</u>. The motion passed unanimously.

MS. HARBO asked about removing the REIT fund from the watch list. MR. BADER said staff performs a three-part quantitative test on portfolios on the watch list, and the REIT fund does not meet the criteria for removal from the watch list yet.

MR. BADER said staff was recommending that Mariner Investment Group be placed on the watch list for ownership changes. He asked Mr. O'Leary, the Board's general consultant, to provide his perspective.

MR. O'LEARY gave the particulars of the Japanese firm that was acquiring Mariner. He said the founders and current shareholders of Mariner would continue to have a significant equity interest and were covered by lengthy employment contracts. Jim McKee, who heads up Callan's hedge fund research, did an on-site visit and also met with a representative of the acquiring firm. Any ownership change is a source of potential concern, and Callan is concerned about the incentives for the next generation at Mariner, who are not immediate beneficiaries of this transaction. Callan was told it was a high priority for Mariner to develop and implement incentives that will keep the next generation interested. He said that placing Mariner on the watch list was an appropriate action so staff and Callan can monitor if that is what actually happens.

MR. RICHARDS moved to place Mariner Investment Group on the watch list [for an ownership change]. MS. HARBO seconded.
The motion passed unanimously.

MR. BADER informed the Board of a possible grant of mineral rights on Louisiana property in the farmland portfolio managed by UBS. He said the ARMB is acquiring substantial land across the nation through its timberland program and farmland program. Frequently, there are opportunities to achieve a higher and better use of the property through things like mineral rights and wind power generation.

MR. BADER reported on a change in the investment contract for the J.P. Morgan Strategic Property Fund to raise fees by two basis points, representing approximately $35,000 a quarter. He said it was not something that staff was pleased about, but he recommended proceeding with the investment and looking for alternatives.

MS. HARBO moved that the ARMB approve amending the contract for the J.P. Morgan Strategic Property Fund, as described by staff. MR. WILLIAMS seconded. The motion carried unanimously.

MR. O'LEARY brought the Board up to date on a far-reaching and extensive investigation by the SEC (Securities and Exchange Commission) and the FBI into whether some money managers gained access to insider information regarding financial developments at various companies and then acted upon that information to benefit those for whom they invested and themselves. The ARMB's apparent exposure is very small. He said Callan was monitoring the situation closely, as was the ARMB staff, and they would keep the Board posted of any developments.

MR. PIHL asked if the Board could take up the KPMG Audit Report next because it dealt with the prior fiscal year, followed by the Financial Reports that dealt with the current fiscal year. No one objected, and the agenda was amended.

6. KPMG Report of 2010 Audit Results

MIKE HAYHURST, managing partner in the Anchorage office of KPMG LLP, introduced CORRINE FIEDLER, a senior manager in Anchorage and also engagement manager on the subject audits. They presented the fiscal year 2010 audit results for the State of Alaska Department of Administration - Division of Retirement and Benefits (DRB), and the

Department of Revenue - Treasury Division. *[KPMG had a series of slides that contained the main points of the presentation, which are on file at the ARMB office.]*

MR. HAYHURST covered the responsibilities of the divisions, the Audit Committee, and of KPMG in the audit process. He stated that in the two years he has been working on the account, at each Audit Committee meeting he and the engagement manager have taken numerous questions from committee members about procedures that either KPMG or internal audit perform. His opinion was that the Audit Committee is appropriately discharging its duties and responsibilities in that regard.

MR. HAYHURST said there were no significant changes to the audit plan that was set out at the beginning, and there were no pending matters that hang over the issuance of the audit opinion. He reported that at the end of the FY2010 audit KPMG issued unqualified (or "clean") opinions on all the financial statements. Those financial statements included:

Treasury Division

- Invested Assets of the Retirement Systems
- Treasury Division Invested Assets Under the Investment Authority of the Commissioner of Revenue

Division of Retirement and Benefits

- Public Employees' Retirement System
- Teachers' Retirement System
- Judicial Retirement System
- National Guard and Naval Militia Retirement System
- Supplemental Benefit System
- Deferred Compensation Plan

VICE CHAIR TRIVETTE sought and received confirmation that the KPMG audit did not audit the dental/audio/visual, long-term care, or life insurance programs.

MR. HAYHURST reported one adjustment related to the financial statements, which was a recurring adjustment. The financial statements do not reflect the market value adjustments for the alternative investments, which report their financial information lagged one quarter. KPMG received the updated valuations by the end of the audit and assessed whether the information would make a material difference on the financial statements if they were updated to reflect the updated valuations. While one item reached KPMG's listing scope, it was clearly inconsequential when compared to the $8.0 billion PERS fund balance and $4.0 billion TRS fund balance. However, KPMG accumulates those numbers to determine if something is consequential. Through communications, there were no other qualitative matters that came up that would cause KPMG to believe that something quantitatively material should be reflected in the financial statements.

MR. HAYHURST stated there were no deficiencies identified in internal controls that they would consider to be material weaknesses or significant deficiencies in internal controls. Every audit requires looking at the potential for fraud, and he characterized the DRB and Treasury as being environments at the lower end of the fraud scale. However, KPMG looked at the potential for fraud related to contributions, as well as in management override of controls, primarily in journal entries and post-closing entries. They also examined significant estimates and judgments where management bias could come into play, specifically the actuarial amounts of the unfunded and funded status of the retirement plans on the DRB side, and the evaluation of securities on the Treasury side. No matters came to light that caused an issue in the audit.

MR. HAYHURST reviewed a list of other required communications. He reported that regarding other documents that contain the audited financial statements KPMG expected to get a copy of the CAFRs (Comprehensive Annual Financial Reports) for PERS and TRS before those are issued in draft form so they could read them and complete the necessary procedures.

Responding to VICE CHAIR TRIVETTE's question about getting notification regarding the outcome of the audit procedures on the CAFRs, MR. HAYHURST said KPMG would notify staff of any comments and could also send an email to the chair of the Audit Committee.

MR. HAYHURST related that KPMG did not encounter any significant difficulties during the audit, they had the full cooperation of staff, and there were no disagreements with management on accounting or auditing matters. KPMG was not aware of staff consulting with other accountants to get advice on the audit procedures or the conclusions. There were no alternative accounting treatments discussed with management in the current year, and no new standards issued that had a material impact on the financials. He confirmed that KPMG was an independent firm and acted independently in performing their audit.

MR. PIHL mentioned that the Audit Committee at its October meeting had objected to the legal fees connected to the Mercer case being included in the administration costs line. He was pleased to see those legal fees listed on a separate line in the final financial statements, and that regular legal fees actually decreased from $20 million the previous year to $14 million in FY10.

VICE CHAIR TRIVETTE said he attended some of the Audit Committee meetings, and he thanked the people from KPMG for their work.

7. Fund Financial Report With Cash Flow Update

State Comptroller PAMELA LEARY presented the financial report for the first quarter of fiscal year 2011. Total assets increased 9.1% for the quarter, and 7.5% was due to investment income increases. Total assets were $17.7 billion at September 30, 2010. She said the latest numbers available on the website show another 3.8% increase for the month of October to bring total assets to $18.4 billion.

MS. LEARY reported that the asset class allocations for all the systems were within the target bands, with fixed income being on the low side. She also briefly reviewed the investment returns for the various asset classes.

MR. SHIER reviewed the Division of Retirement and Benefits supplemental financial report as of September 30, 2010.

VICE CHAIR TRIVETTE called a break from 10:04 a.m. to 10:14 a.m.

8. Independent Fiduciary Services Report

MR. BADER reviewed the background to the ARMB contracting for an evaluation of the performance measurement team and the board policies that is done every four years. He introduced STEVEN HARDING and BARBRA BYINGTON with Independent Fiduciary Services (IFS) to present the findings of their firm's evaluation. *[A copy of the Independent Fiduciary Services report is on file. A verbatim transcript of the entire meeting may be reviewed for more details and is also on file at the ARMB office.]*

MR. HARDING gave a brief overview of the firm, noting that IFS conducted an operational review of the ARMB's predecessor, the Alaska State Pension Investment Board, seven or eight years ago.
He also mentioned the team members that conducted the current review of the ARMB. He said the scope of work covered four task areas: (1) investment performance calculations and methodology; (2) investment performance reporting; (3) investment performance benchmarks; and (4) investment policies.

(1) Investment performance calculations and methodology:
MR. HARDING stated that IFS found that the ARMB's consultants, Callan Associates and the Townsend Group, were using appropriate methodology to calculate the investment performance. IFS spot-checked the quarterly performance reporting for the March 31, 2010 quarter and reviewed four external managers and the in-house fixed income portfolio. They found that the reporting was being done properly and accurately. Callan accurately calculated performance on a quarterly basis, and also on a linked basis where they looked at one-, three-, five-, and ten-year time periods. The same was true for Townsend.

(2) Investment performance reporting to the Board:
MS. BYINGTON said the performance reports the Board receives are high quality and in line with best practices for public pension funds. IFS found Callan's detailed performance report to staff to be quite thorough, and the executive summary and the in-person performance overview to be very helpful. She said the IFS report included a list of exhibits that they felt should be included in quarterly performance reports, and their comments on whether Callan was fulfilling the requirements for each exhibit. In general, they found

Callan was doing that. Callan also provides a separate annual report on the private equity program, in addition to including time-weighted performance for private equity in the quarterly reports. IFS wanted to see some additional items in the annual report on private equity, depending on how much detail the Board wished to get. One item was an internal rate of return (IRR) for the entire private equity program, besides the IRRs for the two main oversight managers, Abbott and Pathway. The overall IRR becomes more important as the internally managed portfolio of private equity grows over time. The second item to possibly add would be the IRRs for the various strategies within the private equity program.

MS. BYINGTON stated that the defined benefit performance report should include the internally managed REIT (real estate investment trust) portfolio and the TIPS (treasury inflation protected securities) portfolio in the investment manager returns exhibits, and there should be an additional investment summary page for the TIPS portfolio. She said it was important to treat all the internally managed portfolios the same as an externally managed portfolio in terms of monitoring and reporting. Also, reporting for the farmland and timberland programs, which are both quite small, could be enhanced. ARMB staff has expressed the desire to work with Callan to improve what is currently very basic performance reporting.

MS. BYINGTON said Townsend does the performance reports for real estate, and those contain the appropriate information, in general. IFS felt the real estate reports could be improved with some supplemental information, such as the internal rates of return (in addition to the time-weighted return) for the individually managed accounts.

(3) Investment performance benchmarks:
MS. BYINGTON first reviewed the characteristics of a good performance benchmark. She said that overall the appropriate benchmarks were being used for the ARMB investments, and IFS had only some minor recommendations. The most important was to establish the policy benchmark for the total fund in a policy document. The managers also have strategic benchmarks or style-based benchmarks; after discussions with staff, IFS had a few recommendations to either add an additional benchmark or change a benchmark.

The public portion of the real estate portfolio (REITs) was part of the real estate benchmark, but it was not rolled up into the real asset composite benchmark, and IFS thought it should be done on a corresponding basis. Regarding the defined contribution plan, IFS recommended a more appropriate benchmark for the RCM Socially Responsible Equity Fund, perhaps in addition to the current S&P 500 Index benchmark. Lastly, there was no policy to specifically deal with the energy investments, and energy also was not identified as part of the real assets benchmark.

(4) Investment policies:
MS. BYINGTON stated that ARMB, unlike some other public pension funds, does not

have a total fund investment policy statement. Instead, ARMB has a series of investment policies, primarily for various asset classes, but also for some subasset classes, plus the rebalancing policy and the watch list policy. IFS suggested having an additional total fund policy statement that would include things like the total fund investment objectives, the actuarial rate of return, the Board's risk tolerance, the roles and responsibilities of the various parties, and the liquidity needs of the pension funds. IFS also recommended instituting an annual review of each policy to check if any changes were warranted.

MR. O'LEARY commented that the Board has adopted policy documents for individual segments of the portfolio, but he thought it was a good suggestion to document everything together with the underlying detail.

MS. BYINGTON next went through the individual asset class policies and any recommendations IFS had for each. One suggestion was that the broad policy for the public equities asset class could be narrowed, and then have separate guidelines for each subasset class within public equities. Unlike equities, the ARMB's fixed income has separate policy statements for each of the strategies. IFS recommended looking at adopting specific guidelines for each fixed income manager. Further, IFS felt it was important to treat the internally managed portfolios the same as externally managed portfolios; for example, having a separate policy that spelled out how to manage the TIPS portfolio and how it should be monitored and evaluated for performance. IFS also recommended having separate guidelines for managing the internally managed REIT portfolio. Another recommendation was to talk to Townsend about setting a policy for the appropriate amount of leverage in the value-added and non-core commingled funds in the real estate portfolio.

MS. ERCHINGER asked if IFS considered the magnitude of internally managed funds in its study and whether there should be a policy to guide the size of internally managed funds versus externally managed. MS. BYINGTON replied that they did not look at that as part of the current review because they were looking at specific policies. She suggested it was something to address potentially in a total fund policy statement, where the Board could decide which strategies it would want to manage internally versus externally.

MS. ERCHINGER noted that IFS recommended that the Board consider setting leverage limits by strategy type in real estate. She asked if IFS also had a recommendation about setting a leverage limit for the real estate portfolio as a whole.

MS. BYINGTON said it was a good point. IFS understood that the Board's philosophy has been quite conservative over the years in terms of real estate, which is why the bulk of the portfolio has been in separate accounts that have not really used leverage at all. She said if the Board did add a leverage limit for the core or the non-core, it would make sense to roll that up and have a total leverage policy for the entire real estate program.

MS. BYINGTON stated that the timberland policy was very brief, and it would be good to build out that policy to follow the model of the ARMB's other private assets. The farmland policy was very thorough, and IFS suggested only minor clarifications, such as what could be invested outside the U.S. The private equity policy was also very comprehensive, and the recommendations were minor. One was to include some language in the policy to indicate the Board's awareness of the risks associated with the private equity asset class. International private equity has a 35% limit, and the Board might want to set a range in policy to allow more flexibility in that area, rather than just ratcheting up the limit from time to time.

MS. BYINGTON said the absolute return policy was generally very comprehensive. Recommendations included creating separate guidelines for each fund of fund manager that were tailored specifically to a manager's strategy and mandate.

VICE CHAIR TRIVETTE asked if IFS had a model guideline for a fund of fund manager. MS. BYINGTON said she was sure she could get one for ARMB.

IFS had several recommendations for the ARMB's rebalancing policy. First was to revisit the rebalancing ranges that have been in place for a while and consider whether to have wider or narrower bands, depending on the Board's risk tolerance and its willingness to delegate more decisions to staff.

MR. O'LEARY explained that a unique challenge confronting the ARMB staff is the extensive use of asset class pools to provide the multiple plans with the desired overall diversification. Each plan has a unique cash flow, and rebalancing is a substantial effort, administratively. He asked if IFS was aware of other systems that are confronted with that type of issue that staff could speak with and get some useful, specific insights.

MR. HARDING mentioned that New York City had a similar structure with five or six pension board associated with the overall fund management, but he did not know what they were doing currently.

MS. BYINGTON spoke of a firm that marketed a very technical and quantitative rebalancing program and software.

MR. O'LEARY said a unique aspect for ARMB that had a potential impact on liquidity was the extensive use of real assets and not knowing the true current value of those to be able to determine whether the asset allocation was in balance or not. Even once staff knew the answer to that, they might not be able to do anything about it. MS. BYINGTON assured him that IFS was not saying that ARMB was doing anything wrong; they were just suggesting revisiting the rebalancing ranges to see if the Board wanted to do anything differently.

MS. BYINGTON said the last policy IFS looked at was the manager watch list policy, and they had a couple of recommendations. She said staff has told them that they felt the quantitative criteria needed to be adjusted to account for passive and index managers, and IFS agreed with them on that point. They thought a few areas of the policy could be clearer, such as exactly how a manager gets on the watch list and if anything needs to happen once they are on the list, such as meetings, additional due diligence, or reporting requirements.

ARMB legal counsel ROB JOHNSON commented that one problem with guidelines and procedures for watch lists is that, to the extent they are formalized, it starts to implicitly be a part of the manager contract about what has to be done to terminate a manager. He asked IFS if they had run into a situation of walking the fine line between a review mechanism and still wanting to keep the maximum flexibility in terms of a termination decision.

MS. BYINGTON responded that the watch list does not have to spell out that a manager can only stay on the list for 12 months and then either be terminated or taken off the list. The current watch list sort of rates managers as meeting expectations, exceeding expectations, or being below expectations. The current policy is silent on some areas where other funds require that a manager that hits certain criteria must come in and have a meeting, but that does not necessarily lead to terminating them. Another issue is that a manager could stay on the watch list forever with no action being taken, and there should be a record of why the Board chooses to keep that manager.

MS. ERCHINGER pointed out that the simple addition of a column to the watch list to indicate when the Board discussed a manager and why the manager was being kept on the list would probably take care of IFS's recommendation.

Regarding liquidity affecting various recommendations, MR. PIHL asked if the funded status entered into how IFS looked at things and the recommendations they made. MS. BYINGTON said no, that IFS was not tasked with looking at asset allocation. MR. HARDING added that there was a corollary between the funded status and meeting cash flow needs, and perhaps ARMB could talk to funds with a similar funded status to find out how they meet liquidity needs.

VICE CHAIR TRIVETTE thanked the people from IFS for their detailed report, saying he was glad to finally get the results after the long delay in awarding the contract. He noted that Mr. Bader had said staff would be evaluating all the recommendations in the report and bringing suggestions to the Board systematically over time. His idea was to refer the report to a committee that could come back to the Board with a formal recommendation.

MS. ERCHINGER said the IFS report had great recommendations, but it was positive to see how few of the recommendations pointed out deficiencies in the current ARMB policies and guidelines. She thought it meant that IFS recognized the great work that was already being done and the input the Board was getting from its existing consultants.

9. Private Equity Evaluation

GARY ROBERTSON, Senior Vice President of Callan Associates, Inc., presented his annual review and performance analysis of the ARMB private equity portfolio. *[A copy of the slide presentation is on file at the ARMB office, and a verbatim transcript is available to read the details.]* He said at last year's report things were in the depths, but fiscal year 2010 was a nice uplift, although the market is nowhere near the high water mark.

MR. ROBERTSON quickly reviewed how private equity works, as well as how the money flows from the ARMB to the general partnerships to the companies and then back to the ARMB in the profitable stage of partnerships over time. He traced the history of the ARMB's private equity program from its start in 1998 with a 3% allocation that was raised to 6% in 2001 and then to 7% in 2006. The ARMB initiated an in-house private equity portfolio in 2007.

MR. ROBERTSON presented a summary of the funded status of the private equity program. The private equity target rose by $123 million in the fiscal year because the total retirement fund assets increased. Abbott Capital Management represented 50% of the portfolio, Pathway Capital Management represented about 45%, and Blum and the in-house constituted the remaining 5%. The net asset values of the managers increased over the 12 months, except for Blum, which went down a bit largely due to liquidation and distribution in the closed-end fund. Overall, the private equity portfolio increased about $220 million, bringing the allocation to 9.6% of the total fund, which was above the 7% target but within the range.

MR. O'LEARY clarified that the increase in the portfolio in the year came from a combination of gains and the addition of capital.

MR. ROBERTSON presented an historical graph of private equity market conditions from 1996 to 2010 to illustrate at what point in the business cycle the ARMB managers were making commitments. He said that investments made during the dips in the market tend to produce higher returns than commitments made during the peaks, which reflect on the long-term performance. Abbott started in 1998 and drew capital right at the peak, meaning they had a headwind due to timing. Pathway was hired in 2001, a very beneficial time to put money in, and with the leverage boom then and also a buyout boom, there was no J-curve whatsoever. The Board hired Blum in 2005 and, like Abbott, they invested right into peak pricing. The in-house program started in 2007 and so very little capital in the first few investments was at the high prices.

MR. ROBERTSON stated that the growth and profits of companies declined in the recession. There has been some tenuous profits recovery, but everyone acknowledges that it is largely from cost cutting and not so much from growth. That is the missing piece going forward. Private equity has been very slow over this time, as far as activity and cash flows. The capital markets have seized up. When the general markets catch a cold, private equity gets the flu, and that was evident in last year's numbers. Things have picked up a little but not a lot, and the ARMB's commitments have contracted.

The good news is that private equity values bottomed in the first quarter of 2009, and the subsequent four quarters have averaged about a 5% increase. That has lagged the public markets because of the mark-to-market accounting used to value portfolio companies. The debt markets are what has slowed down private equity activity the most, and also pricing to some degree. The bank loans are just not there, and for buyouts specifically, which are probably close to 80% of the market, borrowing is what keeps the engine running. Because of the cyclical decline, now should be a relatively good time to put capital into companies. Prices are not overheated now but not cheap either; they are pretty much at what people think are fair values. Callan is cautiously optimistic because, like for other asset classes, this is a new environment and there is a lot going on that could make the markets go up or go down. Private equity is a leveraged equity, and that is how it will behave in the future.

MR. RICHARDS had a question about what the report meant by "The availability of senior bank loan financing will need to increase substantially before private equity activity can accelerate."

MR. ROBERTSON explained the capital structure of a buyout that usually involves around 50% in bank loans, and that banks are nervous because they made a lot of bad leveraged buyout loans right at the peak of the market.

MR. O'LEARY added his perspective that deals were being done in 2007 and 2008 that had no right to be done, because money was cheap and available. Now lenders are requiring more equity cushion from the companies and more stringent covenants associated with their debt. A good buyout firm or private equity investment will succeed by having less leverage and being a business that is soundly structured and well-managed. Bank loan financing is a big part of leveraged buyouts but it is trivial with regard to venture capital, which is less than a quarter of the marketplace.

MR. ROBERTSON said he agreed with Mr. O'Leary's prudency comments, but having a little more private equity activity would not be bad for the ARMB because the portfolio would be getting a lot more money back.

MR. PIHL asked what role the new banking regulations would play for private equity financing in the future. MR. ROBERTSON replied that the Dodd-Frank bank reform bill has no prohibition regarding the banks' ability to lend. MR. O'LEARY added that what will be significant is investment banks getting rid of their proprietary trading because of the legislation, and it will be difficult for banks to have a piece of the private equity action for their own account.

MR. ROBERTSON showed a chart of private equity industry returns by strategy over various time periods. He noted that one year ago the one-year return for all private equity was -25%, and in 2010 the one-year return was 21%. Of note was the 3% to 4% spread in return of private equity over public equity over time, except for the one-year period. He said he had calculated the time-weighted return in various time periods (versus the internal rate of return), and the spread between private equity and public equity was more like 6%.

MR. O'LEARY commented that if public equities returned 10%, a reasonable, minimum expectation would be to get a net return of 13% from private equity, and hopefully closer to 15%.

MR. ROBERTSON next reviewed the ARMB's total portfolio performance for the 12 months ended June 30, 2010. Commitments totaled $2.8 billion, an increase of $121 million. Paid-in capital went up a little more than the commitments, meaning the uncalled capital waiting to be invested in companies went down slightly. Investment activity was slow in FY10 and commitment activity was slow. Distributions in the year picked up to $143 million.

Total partnerships in the portfolio were 226, up 11 from last year -- a low number compared to 25 new partnerships in the year before. The portfolio was 71% paid-in, up from 69%. Net cash flow was $17 million, down from $100 million last year, so cash flows are changing quite a bit, especially on the distribution side. The portfolio had unrealized appreciation of 19%, and last year had 25% unrealized appreciation, so the portfolio has seen a nice recovery.

MR. BADER told the Board that money that is committed to private equity but not called is invested in the rest of the portfolio. When a manager notifies that they want some of the money that the ARMB has committed, staff sells stocks or bonds to satisfy that call and tries to work towards rebalancing.

MR. ROBERTSON also reviewed the 12-month performance for the Abbott portfolio. Unrealized appreciation was 19%, compared to 25% unrealized depreciation last year, so a nice recovery underway. Abbott's internal rate of return of 8.0% was second quartile compared to funds formed in the same year, but high in the second quartile; they were essentially first quartile overall. Callan added a chart to look at the performance of individual strategies in the Abbott portfolio, per a recommendation in the IFS report.

MR. ROBERTSON reviewed the 12-month performance for the Pathway portfolio. They increased the number of partnerships by six in the year, so more commitments than Abbott, but still a very slow commitment pace for them. Unrealized appreciation was 18%, versus 25% unrealized depreciation last year. Net asset value increased $108 million, or 23%. For the eight years, Pathway's performance was 10.5%, all first quartile, except for special situations.

MR. ROBERTSON highlighted that while it might look like Pathway was doing better than Abbott in certain regards, 10.5% IRR versus 8%, Abbott has made $1.30 for every dollar the ARMB has put in, while Pathway has made $1.24 for every dollar put in. Both firms are doing very well on one measure or the other. Abbott has actually been 30% more profitable to this point, but the portfolio is four years older.

MR. ROBERTSON displayed pie charts of the ARMB private equity diversification first by strategy, and also by industry and geography. He pointed out that Abbott does not do distressed debt but Pathway does, and Pathway does no mezzanine debt, but Abbott does -- a nice complement. The ARMB gets a lot more venture capital exposure from Abbott, and Pathway has a buyouts tilt in their portfolio. By industry, ARMB's biggest exposure is in the tech area (22%), which is a big grouping that includes both hardware and software. The portfolio has great diversification geographically: 30% international and the rest in domestic with no major exposures or over-exposures.

Turning to the in-house private equity portfolio initiated in 2008, MR. ROBERTSON said it was invested in five partnerships. Every fund is in a different strategy -- distressed, buyout, mezzanine, and secondaries -- all areas where the private equity oversight managers are underweight. The unrealized appreciation was 19% on this very new portfolio. The J-curve was exacerbated by the down turn in the general markets and now the portfolio is back to whole, so the timing was good on this portfolio. As new investments are added, there is a good chance the portfolio will re-enter the J-curve. The fundraising market has been slow in the last two years. The most attractive partnerships have been in both the Abbott and Pathway portfolios, and the in-house portfolio has let those opportunities pass because Abbott and Pathway were going to do them.

MR. ROBERTSON stated that the corporate governance portfolio had 14 positions left. There has not been any real clear value added, but it was at a break-even point. The portfolio has behaved like a concentrated small cap portfolio.

In conclusion, MR. ROBERTSON said the oversight managers were invested in very high quality, well-regarded partnerships. The portfolio was currently over its target, but Callan expected that to moderate over time. Because the retirement fund is so large, any changes in the value of the fund can make big changes in the private equity portfolio funding. The companies that came through the recession are strong and efficient, and to the degree there is growth, that should be able to drop back to the bottom line quite handily. There is a fair amount of uncalled capital, so the portfolio should show good progress going forward.

VICE CHAIR TRIVETTE thanked Mr. Robertson for his report and called a lunch break at 11:57 a.m. The meeting came back to order at 1:15 p.m.

10. External Manager Review

MR. BADER filled the Board in on staff's preparation for the annual manager review that took place on October 21, 2010. He said Mr. O'Leary, Dr. Jennings, Mr. Wilson, Ms. Hall and he met to review the responses to the manager questionnaires and to discuss items of general interest.

Certain managers were selected for extended discussion. After discussing some of their organizational changes, the group had no particular recommendations related to RCM, Brandes Investment Partners, Relational Investors, and Capital Guardian International.

[The staff summary of the manager review discussions and other topics has been inserted into these minutes.]

BACKGROUND

In preparation for the annual Manager Review meeting with the Investment Advisory Council (IAC) members and the general consultant (Callan), staff updated and sent the 2010 Manager Questionnaire to all investment managers under contract with the Alaska Retirement Management Board (Board). The questionnaire topics can broadly be classified as: Ownership/Structure, Process, Portfolio Performance and Characteristics, and Other Issues – including the investment process, change in ownership, growth of assets, and legal issues.

Every manager completed a questionnaire, and the responses were provided to the CIO, Callan, and IAC members. After reviewing all questionnaires, the group met to discuss the manager responses and other matters to be brought before the group. Participants in the review were Gary Bader, Chief Investment Officer; Judy Hall, Board Liaison Officer; Michael O'Leary, Callan Associates; and Dr. Bill Jennings and George Wilson, IAC members. The reviewers met in Denver on October 21, 2010.

STATUS:

Certain managers/asset groups were selected for extended discussion:

McKinley Capital Management	Small Cap Pool (Lord Abbett and Luther King)
RCM	Brandes Investment Partners
Mariner Investment Group	Relational Investors
T Rowe Price target date funds/stable value	Cap Guardian International
Eaton Vance	Private Equity
Farmland/Timber/Real Estate Program	

With respect to RCM, Brandes, Relational, and Cap Guardian International, after discussion on organizational structure/changes, benchmarks and performance, the group had no recommendations for further action by staff or consultants.

McKinley Capital manages a large cap growth mandate and an international mandate for the Board, and has been on the Watch List for the past year based on a recommendation from the review meeting in 2009. Mr. O'Leary noted that there were no changes of substance, but the development of the New York operation should be further investigated. Recent performance numbers were reviewed and discussed, along with benchmark comparisons. *Consensus: Staff to meet with McKinley to identify whether there is an edge in international space, with consideration to scaling back mandate; then report to Board.*

Mariner Investment Group has been on the Watch List since April 2008 for underperformance, and would be placed on Watch List now for an ownership change. Mr. Bader observed that the managers always report that everything will remain the same after a merger or acquisition, but over time it always seems that things trail off. He had instructed staff to balance the allocation between absolute return managers. Mr. Bader questioned if it was time to turn the page on this asset class since it has never come close to achieving the goal of a 5% real return. Mr. O'Leary noted that the relative performance is okay, but the stated goal has not been achieved. Mr. Wilson stated he agreed with Mr. Bader's comments regarding organization changes. *Consensus: Evaluate the change of ownership with Mariner, continue watch list placement and equalize the absolute return portfolios.*

The group had an extensive discussion regarding the small cap pool: the assets under management, performance, and the amount invested in passive Russell 2000 indices relative to that actively managed by Jennison, Lord Abbett and Luther King. Mr. Bader noted that the active managers have a growth tilt, but the passive managers had more under management which dominated performance – in rebalancing he would take from passive. The group further discussed the composition of the small cap pool and whether a more balanced approach should be put place. *Consensus: After selection and hiring of microcap managers, revisit small cap pool structure. Nothing with respect to the active managers is a concern.*

T Rowe Price manages the target date funds for SBS, deferred comp and the defined contribution plans. The group had no issues to discuss regarding this mandate, but Mr. O'Leary recommended that staff conduct an annual review of the glide path in relation to its peer group. With respect to the stable value fund managed by T Rowe Price, Mr. Bader stated a potential problem with the Reality Investing optimizer selecting this fund for participants. It could result in a mass movement out of the fund which had negative consequences for remaining participants. *Consensus: staff to conduct an annual review of target funds glide paths. Staff will recommend to Board that the stable value fund be eliminated as a choice for the Reality Investing optimizer.*

Real Estate Program: Mr. O'Leary stated that he recently saw an article that said ARMB was making no new investments in real estate – and that this was incorrect, the real estate managers have lots of uncommitted capital so the Board made no new allocations to the program. Mr. Bader noted that the past couple of years has been a learning experience regarding the difficulties of being in commingled funds. His position going forward will be that there must be a compelling reason to be involved. Mr. O'Leary and Mr. Wilson agreed. Mr. Bader observed that after the annual Real Estate Committee meeting, a trustee had asked why the other assets within the Real Assets allocation were not included in the committee review and staff agreed that a revision of the committee's focus should be considered. *Consensus: Staff will prepare a proposal for a Real Assets Committee for Board consideration.*

Timber: Dr. Jennings noted that the timber allocation was slower to go out than planned; Mr. Bader agreed, but said that staff's position was not to prod managers to invest, but to always look for the best deal. Mr. O'Leary stated that volatility in the asset class has increased because of the magnitude of the recession and also new accounting standards tied to the appraisal process.

Farmland: Mr. Bader noted that the program had been carefully designed with certain parameters: a 5% real return, 20% permanent and 80% row crops, and it has worked well. UBS shows underperformance with NCRIEF, but they are doing what the Board asked and are meeting targets. Mr. O'Leary stated a concern with the queue – more managers are not taking separate accounts in order to channel investors into commingled funds. Place in the queue is based on the signed contract each quarter. Mr. Bader said that Brian Webb leaving UBS was of some concern.

Other Topics:
Asset allocation with multiple asset groups: In response to a question from Dr. Jennings relating to real assets, Mr. O'Leary stated that for asset allocation purposes, Callan creates a policy level composite; the policy remains constant for a year. In this composite, energy gets short shrift, as does differentiation between farmland and commercial real estate. Dr. Jennings wondered if something has been lost in the asset allocation discussion by moving to 6 asset class levels. Mr. Bader agreed that this might be the case particularly being constrained in real assets. The large asset classes create simplicity and clarity for the Board, but create rebalancing challenges. Mr. O'Leary noted that the number of major asset categories could remain low, but broadening the bands would provide an increase in operating flexibility to deal with the denominator problem.

Mr. Bader stated that he intended to introduce several "tail risk" and volatility reduction strategies to the Board as educational topics. Mr. Wilson agreed that education for the Board is important. Mr. Bader indicated that he would probably have Citibank and Goldman talk about Libor Floors and Put Collars as a possibility.

Active vs. Passive: Charts were provided illustrating the active vs passive allocation with the large cap and small cap mandates. Mr. O'Leary noted that the definition of active and passive makes a difference as to how it is categorized, i.e., convertible bonds and covered calls.

While realizing that there have been significant manager changes over the past few years, Mr. Wilson noted after payment of management fees, active management of the ARMB equity portfolio had not beaten its passive benchmarks for a number of years. Mr. Bader noted that

ARMB staff and the Board are continuing to monitor the appropriate level of passive management and this will be discussed at future board meetings.

Mr. O'Leary noted the persistent move to passive in large cap space and stated a personal preference for active management even in large cap. He advocated a lower weighting for passive in small cap and international. Mr. Bader said the large cap allocation is now 55% passive. *Consensus: Large Cap Passive Target for coming year – 60%; look at Relational and McKinley for trimming.*

Assets Under Management: During the general discussion of certain managers, Dr. Jennings had noted the size disparity of manager mandates within the international allocation. Brandes has $736 million, McKinley, $283 million, SSgA $239 million and Cap Guardian $494 million. Dr. Jennings suggested reducing the positions of McKinley and Lazard and creating a 20-25% index target. The group discussed investment manager assets under management (AUM) from two perspectives: First as a percent of the ARMB's investments, and second from the perspective of ARMB's investments as a percentage of the investment manager's AUM. *Consensus: That the CIO report to the Board with a recommendation for addressing these two issues.*

11. Performance Measurement - September 30, 2010

MICHAEL O'LEARY, Executive Vice President of Callan Associates, Inc., presented the third quarter 2010 investment performance for the retirement funds. *[A copy of the Callan presentation slides is on file at the ARMB office.]* He showed a chart of historical data for the most recent recession and the preceding seven recessions that illustrated that this economic recovery has been slower than other recoveries. Housing is very important to jobs and very important to wealth, and the absence of any real improvement is discouraging. One in 20 homes is in foreclosure. He said one of the great advantages the U.S. has is a highly mobile workforce, but being unable to sell one's home and buy another home in a new area immobilizes the work force. Another element is the timing impact of the cessation of foreclosure proceedings, which does not mean the foreclosures are going away.

MR. O'LEARY mentioned that there were other headlines subsequent to the September quarter end: the impact of QE2 (Quantitative Easing 2 where the Fed is further expanding its balance sheet by buying U.S. Treasuries), the significant spike in commodity prices, concerns about deficit reduction, and renewed concern about the euro. The story in the September quarter was, in large part, a reversal of the June quarter. What happened to the stock market and Treasury yields when QE2 was talked about versus what happened when it was announced is a message to the Board in setting policy to not rely on the headlines to tell it what to do or what to be worried about.

MR. O'LEARY said the 10-year bond was below 2.5% and in less than 30 days rose to 3.01% -- a huge change. This had implications for Callan when developing their capital market projections and what the long-run projection for bonds will be, with interest rates so low but possibly going to rise. He presented a graph of total rates of return for several segments of the bond market for the quarter ended September 30 and for the trailing 12 months and noted that lower-quality bonds generally did better in the year. Many of the areas had negative returns subsequent to quarter end because of the increase in rates. International bonds had a huge outperformance for the quarter but actually underperformed over the 12-month period. The norm has been for funds across the country to increase their international fixed income allocation, including the ARMB. What a fund's target benchmark is will have an impact on the performance measurement in periods like the September quarter.

MR. O'LEARY also showed a graph comparing the returns of developed international equity and domestic equity over various periods. For the first three quarters of 2010, U.S. stocks did better than developed international stocks, and much of the difference was simply currency.

Another graph from Vanguard showed the spread in stock and bond returns for rolling periods from around 1940 to 2010. For a long time stocks had a meaningful long-term return premium to bonds, and that basically changed when the dot-com bubble burst so that now, with the benefit of hindsight, it looks like bonds were the place to have been invested. Despite the recovery of the markets over the last two years, bonds have continued to do very well. But optimists believe that at some point equities will again return more than bonds over the long term.

MR. O'LEARY stated that returns for direct real estate, as measured by the NCREIF Index, showed further improvement in the quarter. Of concern is that part of the improvement was attributable to a decline in capitalization rates (the lower the cap rates, the higher the value). Income growth has been decent, but there has been a lot of price fluctuation.

MR. O'LEARY presented the actual asset allocation at September 30 compared to strategic target allocations, using the PERS fund as the illustration for all the major retirement systems. The fund was underweight fixed income, slightly underweight in real assets, overweight private equity, basically on target for absolute return and cash equivalents, overweight non-U.S. equity, and essentially at target for domestic equity. The collective overweight to equities helped performance in the recent quarter. Relative to other public funds, the ARMB portfolio has a greater weighting to real assets, and comparatively higher weightings to international stocks and alternative investments. The high weightings to alternatives and real assets affect the investment results because of timing: the portfolio looked better than other funds in 2008 because private equity and real estate were not written down as fast as the general market tanked, and then in 2009 the ARMB portfolio paid the price when private equity and real estate lagged the public markets in their recovery. Private equity was a big detractor to performance in the September quarter, so timing may still be an issue.

MR. O'LEARY mentioned that in the last year or so the Board made two decisions to hopefully reduce the volatility of the total equity exposure. One was to fund a convertible bond manager and include them in the equity pool. The other more recent decision was to start a covered call writing (buy write) program. He said the Board should be disappointed if its domestic equities do not outperform during a declining market environment because that was one of the shorter-term goals behind those decisions.

Looking at the attribution analysis, MR. O'LEARY stated that the ARMB has less in bonds than other public funds and has a more growth-oriented strategy. The equity markets have not done as well as bonds, which is the biggest explanatory factor in the ARMB's relative performance.

MR. O'LEARY stated that the total fixed income performance for the quarter was very good in a relative sense and very respectable for the trailing year. The internal fixed income portfolio was changed to an intermediate treasury portfolio to improve liquidity and reduce embedded equity risk. In flights to quality the relative performance should look good, and he expected the performance to probably trail in normal markets.

MR. BADER raised a point about the in-house bond portfolio that is heavy in Treasuries being measured against the public fund database that is not in Treasuries. He noted also that the convertible bond portfolio, and the buy write portfolio -- which should be safer than the straight equity index portfolio, will be compared against a universe of managers that will largely not be using convertibles and buy write strategies. He asked if staff should be exploring a way to measure the performance against the most appropriate group, because in the aggregate it could look like the ARMB was underperforming when in fact the equities would be a less volatile portfolio.

MR. O'LEARY replied that Callan measures each manager's performance against the most appropriate style group. He offered to help staff in any way to make the results clear to the readers.

MR. O'LEARY noted that the issue of inflows and outflows causing some underperformance for the small cap index funds was discussed extensively at the manager review meeting and covered earlier in the agenda. MR. BADER added that staff intended to come to the Board with a strategy for dealing with rebalancing that did not cost in performance over time.

MR. O'LEARY also briefly reviewed the individual asset class performances for the September quarter and the 12-month period. He then commented on the stable value funds and balanced trust funds in the SBS and Deferred Compensation Plan, as part of Callan's practice of highlighting certain segments of the participant-directed programs in each performance report. He noted the terrific performance of the two stable value options managed by T. Rowe Price. He said stable value is vulnerable to the actions of some participants potentially working to the detriment of other participants when they time changes in interest rates and use stable value as a money market-type fund. The performance rankings for the stable value funds are more influenced by the timing of cash flows to the fund and so are less helpful. T. Rowe Price did a wonderful job of timing the implementation of the SBS stable value fund when interest rates were low. But there was a lot of money invested in higher interest rate environments that is still in stable value, and the fund is benefitting from those earlier investments.

The long-term balanced trust has been a marvelous success, but in terms of pure rate of return, the five-year return for the old Alaska balanced trust is measurably better. That illustrates the difference in stock and bond returns over that five-year period.

In closing, MR. O'LEARY talked about some of the speakers for the Callan Investments Institute, January 31 - February 2, 2011.

12. Lazard Asset Management - Global Equity

TONY DOTE and JOHN REINSBERG of Lazard Asset Management were present to give an update on the global equity portfolio the firm has managed for the Alaska retirement fund since April 1993. The portfolio had a market value of $744 million as of October 31, 2010. *[A copy of Lazard's slide presentation is on file at the ARMB office.]*

MR. REINSBERG first gave a brief organizational update and talked about their concept called Integrated Knowledge on a Global Scale, designed to maximize the local presence of research analysts and portfolio managers so that together they can connect expertise in different parts of the capital structure and try to gain real insight. He also said Lazard's investment process and philosophy have not changed; they still look at companies in a two-part equation to find those that have above-average return profiles that they can get at a lower valuation. Lazard's pattern of return is they tend to participate when markets are going up and to preserve capital while markets are going down.

MR. DOTE referred to a one-page summary that compared the ARMB's former parameters for the global equity portfolio and the revised structure that was instituted October 1, 2010. He said that while Lazard has generated a nice alpha over the index for the Alaska portfolio over 16-1/2 years, it is a different environment now, and everyone is looking for more return to take full advantage of what the capital markets offer. The new structure allows Lazard to allocate more money within the global portfolio to emerging markets, and the all-cap range means they can now include more smaller companies in both U.S. and non-U.S. developed markets. The greater flexibility means the expected return for the global equity portfolio has moved up from 2% over the benchmark to 3% over the benchmark. Lazard intends to maintain the same style of management, and the Board should see the same pattern of results that was seen from them in the past.

MR. O'LEARY asked if the revised benchmark meant the overall volatility in returns would be a bit greater. MR. DOTE said he thought that was true. He added that he characterized the portfolio before the revision as a very low-risk, modest return orientation. Because the new parameters introduce smaller companies and more emerging markets, there is a slightly higher risk allocation. But the trade-off is more expected return with the same pattern of results. MR. REINSBERG said the portfolio would have pretty much the same profile on a risk-adjusted basis. However, in portfolios with the MSCI All Country World Index as a benchmark, whatever happens in emerging markets is one of the big drivers of performance.

MR. RICHARDS asked if Lazard had back-tested the revised strategy, in light of the changing world. MR. DOTE said they back-tested extensively on a number of different options.

MR. O'LEARY explained that Lazard has a very competitive stand-alone emerging markets product, and they have had limited capability to move the allocation to emerging markets up and down -- which has clearly added value. Similarly, but less significant, Lazard has existing capabilities in U.S. mid/small cap and international developed small cap that one can look at to say that they are competitive in those spaces.

MR. DOTE stated that the market forces have fluctuated between emotion and fundamentals in what is a transitional market environment. Both cyclical stocks and emerging market stocks did well again in 2010, led by consumer-related sectors, industrials, telecom and materials. Lazard has had decent stock selection, but their underweight to the cyclical parts of the market, and their stock selection in technology and financials, have hurt them. Lazard is seeing more mergers and acquisitions activity as companies look to provide more exposure within their businesses or have a lot of cash on the balance sheet. The ARMB portfolio was slightly ahead of the index through the end of September, and October was positive but left them slightly behind the index. The portfolio allocation at the end of October was 32% international equities, 37% U.S. equities, 19.5% emerging markets, and about 8.5% small and mid cap U.S. stocks.

MR. DOTE reviewed a graph of the performance for the ARMB portfolio since inception, pointing out the pattern of returns in flat markets, down markets, and rising markets.

MR. REINSBERG talked about the portfolio weightings by sector and by region in the world, noting that it is a diversified portfolio with a lot of holdings. He commented that everyone thinks China is a wonderful place to invest, but maybe not. It is a great place to do business, and the Chinese demand is driving world demand, but that does not mean China offers great investments returns -- so Lazard has been very cautious there since 2007. They are also cautious about the U.S. and have been able to find more opportunity elsewhere, although that may be changing with an uplift on the corporate side of the U.S. landscape. Brazil and South Korea have been very attractive, South Africa seems to be on the upswing, and they find Turkey interesting.

MR. REINSBERG also mentioned the price/earnings and return on equity characteristics of the portfolio compared to the MSCI World Index. He said the world has morphed and he is urging people to forget about thinking of the world in the sense of developed and emerging, and to think about there being a low-growth environment and a higher growth environment, and that there are low-growth markets and higher growth markets. Israel, Singapore, and Hong Kong -- all emerging markets -- are in the developed world. In the current market environment stock selection has become very important.

Lazard believes the arena of lower interest rates may continue for the next year to 18 months, but the era of falling interest rates seems to be coming to an end because it is not sustainable with the level of debt in the world. The level of debt is unsustainably high; deleveraging is working, but it is only working in certain places and is still going to take a very long time. There is a real difference between the winners and losers on the corporate front, and that gap is likely to expand. They expect to continue seeing the great migration of capital from the developed world to the emerging world and back again. For example, the U.S. market has exported capital to China, and it looks like China is exporting its capital and strategically buying resource assets to get that supply.

MR. REINSBERG listed the possible uncertainties and risk: (1) the race to have a soft currency to have greater export competitiveness; (2) the drag of corporate deleveraging on growth and dividends; (3) the sovereign debt crisis and fear of contagion; and (4) China policy decisions. He also referred to bottom-up opportunities and a list of stocks that Lazard believes are very attractive.

MR. REINSBERG stated that valuations in the U.S. are still significantly higher than Europe, and the dividend payout is actually lower. The dividend payout in Japan is the same as the U.S., which Lazard has not seen in the last 20 years, and the valuations are sort of competitive. The valuations and returns in emerging markets, together with the dividend yield, remain very attractive.

MR. REINSBERG explained Lazard's "continuous improvement" process where they hold weekly meetings so portfolio managers can provide feedback to analysts on their recommendations and discuss any changes happening in the portfolio over the previous week. There is also a monthly meeting to review the sectors with all the analysts worldwide; this proved very useful in the European debt crisis that began in January and escalated in May, and they were well prepared for that.

At MR. O'LEARY's request, MR. REINSBERG briefly addressed Lazard's banking status and the impact of financial regulations, both U.S. and European, on the investment business.

13. ARMB Domestic Fixed Income Portfolio

Senior State Investment Officer BOB MITCHELL presented an organization chart for the five-member fixed income team in the Treasury Division. In addition to managing other monies for the State of Alaska, the team manages three mandates for the ARM Board. The largest is the intermediate treasury index mandate at about $1.8 billion that was started in April this year. Second is the treasury inflation protected securities (TIPS) at about $180 million. The third mandate is a residual portfolio that was formerly known as the broad market fixed income portfolio; it has about $50 million and is composed mostly of less liquid securities that staff has chosen to retain and either let run off or sell over time.

MR. MITCHELL stated that the intermediate treasury portfolio provides liquidity for the broader ARMB portfolio. The TIPS portfolio also receives, on occasion, large cash flows, and so it is also positioned to provide a high level of liquidity. He showed a graph that was presented at the February meeting to show the Board how fixed income liquidity requirements had risen over the decade from 2000 to 2010 as the fixed income portion of the overall asset allocation had declined.

MR. MITCHELL spent some time explaining the current investment approach where the fixed income team is expected to provide a lot of liquidity, meaning the intermediate treasury portfolio does not have a large portion in non-treasury securities. They position the portfolio at various points along the yield curve so it can outperform in a broad range of scenarios. Staff relies heavily on analytics to assist in identifying a set of broad scenarios to manage the portfolio against. They do not rely as much on analytics for the TIPS portfolio, where the securities are not as liquid as nominal treasury securities, but instead take smaller tilts versus the index and look at mean reversion along the TIPS yield curve to outperform over time. In addition to the primary strategy, staff has the ability to invest up to 10% of the treasury portfolio in a diversified mix of non-treasury securities, which is consistent with the liquidity mandate.

MR. MITCHELL listed the risks of the investment approach: (1) that staff does not identify a broad enough set of scenarios to manage the treasury portfolio against, and the future is more extreme than they identified; (2) that the risk premia for non-treasury securities may increase, causing the portion of the portfolio not invested in treasuries to underperform in the treasury portfolio, or changing the relationship between TIPS and nominal treasuries in the TIPS portfolio; and (3) that actual changes in inflation may not be the same as inflation expectations.

MR. MITCHELL stated that over the three years of the TIPS portfolio they have included small positions in non-government guaranteed securities for short periods of time, such as late 2008 and early 2009.

MR. MITCHELL presented graphs and charts showing the makeup and characteristics of the intermediate treasury portfolio. He stressed that the non-treasury part of the treasury portfolio is broadly diversified by sector and even within sectors. It is early days yet in terms of looking at performance, since the treasury portfolio only started in April. A similar slide for the TIPS portfolio also included information about the cost to performance in the months that have the most significant cash flows.

Turning to the future prospects for fixed income, MR. MITCHELL said he echoed earlier comments from Mr. O'Leary and Lazard that made the case for lower expected returns from fixed income going forward, and also rising risks. He cited Callan's work that has shown there is a high correlation between the yield of a fixed income index at any time and its subsequent performance. Falling yields resulted in strong fixed income returns for the year that exceeded Callan's 10-year forecast. Rates rose in November however, indicating that fixed income is less compelling than it was at the beginning of this year.

Another graph showed the gross debt/GDP for advanced economies compared to emerging economies from 2006 and projected to 2015, indicating in rough terms the ability to repay the debt issued. The message is that developed country fundamentals are deteriorating. A lot of debt has been issued that will be maturing in 2010 and 2011, and developed nations will have to issue new debt to pay that debt off; further, debt will need to be issued to pay for fiscal deficits that are being incurred in those developed countries. A question is whether the markets will be in the mood to refinance the debt when it comes due. Germany is considered the strongest country in the core of Europe, and it recently did two auctions that did not go well -- and maybe that is the canary in the coal mine. If the demand for buying the securities is not there, then the real yield will have to go up to entice investors to come to the market. That is another risk factor to consider when looking at the fixed income markets.

MR. WILLIAMS asked if staff was mapping the liquidity needs as more and more Tier I employees retire over the next five to ten years. MR. BADER responded that the materials from Buck Consultants show that the peak level of investment in the defined benefit program is still more than 15 years out. Staff is not ignoring the need to have liquidity, and he will be presenting in February a risk package the Board approved for modeling the portfolios that takes liquidity into account. Liquidity is not limited to fixed income and is also taken from public equities, although that option is generally more expensive. But during the meltdown, the spreads on fixed income were very severe, so that is the reason for the intermediate treasury mandate, and staff is keeping an eye on it.

MR. BADER noted that an action item on the second day of the agenda will deal with amending the U.S. intermediate treasury guidelines, and he asked Mr. Mitchell to briefly explain that. The requests were to lift the 5% restriction on securities that are not full faith and credit and to eliminate a coupon-paying requirement.

MR. MITCHELL explained that having managed the intermediate treasury portfolio for six months staff has noticed a couple of aspects of the investment guidelines that do not materially add to the intent of the portfolio to provide liquidity, and instead create some portfolio management issues. One is that the guidelines are silent on what cash is, and staff would like it explicitly stated that cash is included in the minimum 90% of the portfolio that must be invested in treasuries. The coupon-paying restriction means that staff cannot buy T-bills, for example, if staff wants to have a cash component in the portfolio. Currently, there is a 5% limit on what is considered non-government guaranteed securities. Staff believes they could better serve the ARMB if there was one 10% pool to watch, rather than having to manage two 5% portfolios.

MS. ERCHINGER asked if the Board's current allocation to fixed income made sense in light of the market today, when it seems that interest rates may soon start to rise, which would have a big impact. She said the ARMB is not in the business of market timing, but now is an unusual situation.

MR. MITCHELL emphasized that market timing is dangerous because the ARMB would have to be right more than wrong and also have the policy strength to not change horses midstream. For those reasons he defaulted toward not market timing. There are serious benefits to diversification between bonds and equity type instruments. If one were to reduce fixed income, it would be reducing diversification.

MR. MITCHELL said one of the benefits of the bond market is the ability to apply math to it, unlike the equity market. With yields at about 1%, and assuming they were to go to zero all along the yield curve tomorrow, the intermediate treasury portfolio would get a capital gain of about 8%, even though the earnings would be zero. If that 8% were amortized over a 10-year period, that would be 80 basis points a year; that is the upside but not actually the best scenario. The best scenario would be for rates to stay where they are or maybe gradually go up. The portfolio would still face the headwinds of the capital losses as yields go up and prices go down. As Mr. O'Leary said, the best hope for having strong fixed income returns over time is for that to happen sooner rather than later so the ARMB can enjoy the benefits of the higher yield for a long period of time. Lastly, when rates are lower, the diversification benefit of fixed income is also lower because there is more of a cap on how much bonds can rally in a stressful environment. For example, there was a period of about six quarters during the market meltdown where fixed income returned 21%. That is impossible now.

MR. MITCHELL and MR. O'LEARY discussed with MR. PIHL what could happen to the fixed income portfolio if rates start to climb.

14. Financial Reform Review

ROB JOHNSON, ARMB legal counsel, made a presentation on the Dodd-Frank Wall Street Reform and Consumer Protection Act that was signed into law July 21, 2010. He said a lot is not known about the Act because its structure will be fleshed out in the form of rulings, regulations, and probably even case law. It is the implementation of this huge piece of legislation that will be the difficult issue. There are requirements in the Act that studies be done before regulations and rules are promulgated. *[The slides for this presentation are on file at the ARMB office, along with a verbatim transcript of the presentation for more details.]*

MR. JOHNSON stated that no one is telling us specifically how this Act is going to come into play. Right now, large congregations of lawyers -- representing insurance companies, banks, and intellectual capital institutions -- are working together to figure out how to propose structuring the rules to implement the laws in a way that best benefits their clients. Some provisions of the Act are not scheduled to take effect for years after the rules and regulations are implemented, and there are numerous lawsuits challenging certain statutes that have to work their way through the system.

MR. JOHNSON said the Act was triggered by the financial crisis that everyone has been dealing with. He cited some books he found helpful on the subjects of "too big to fail" and on the lack of prudence and diligence at the highest levels that led to the subprime mortgage crisis. He said it is probably wise that institutions like the ARMB maintain its own due diligence efforts in looking carefully through its investment products and the like. The Board also has to maintain an element of diligence itself in the sense of reality, an example being Mr. Mitchell's description of the prospects for bond investments going forward. These prudent actions, rather than legislation, are probably the ARMB's best protection. Notwithstanding that, the Dodd-Frank Act was enacted to correct regulatory neglect and to clarify regulatory gaps, and it provides a great deal more authority by state regulators than existed beforehand.

MR. JOHNSON reviewed the stated purposes of the Act:

- Create an independent Bureau of Consumer Financial Protection within the Federal Reserve.
- Establish new federal government power to wind down large, failing financial institutions.
- Establish a 10-member Financial Stability Oversight Council to oversee systemic risk, strengthen the regulation of financial holding companies, and abolish the Office of Thrift Supervision.
- Place new limits on the amount of money a bank can invest in hedge funds and private equity funds within the Volcker Rule.
- Impose new capital and leverage requirements to discourage financial institutions from excessive risk-taking.
- Establish strict oversight of over-the-counter derivatives market.
- Establish stricter oversight of credit rating agencies, securitization reform, and expand SEC enforcement powers.
- Establish mortgage protections requiring a lender to ensure that its borrower can repay a loan.
- Establish other intended reforms.

MR. JOHNSON addressed the probable impacts on the Alaska retirement fund investments:

- Banks will divest of their investment arms and create affiliates.
- May be an effect on some existing deals as the law starts to firm up.
- Key persons in particular partnerships and various deals may change.
- Staff will have to pay greater attention to the details as they work through limited partnership agreements.
- Greater SEC disclosure requirements.
- Uncertainty about the timing and meaning of the law.
- Will be a greater emphasis on arbitrating disputes, whereas ARMB legal counsel has always advised the ARMB to avoid arbitration and keep matters in the Juneau Superior Court.
- Proxy proactivity will require more attention, as proxy statements become more regulated by the government.

MR. JOHNSON stated that the Dodd-Frank Act was divided into 16 titles, and he briefly reviewed a list of the general subject areas. He also pointed out the many existing federal agencies and instrumentalities and the types of actions mandated for them under the Act. He mentioned that the Volcker Rule amends the Bank Holding Act with a new provision prohibiting a banking entity from engaging in proprietary trading or holding an ownership interest in a hedge fund or private equity fund. The provisions are subject to study and rule-making and a future effective date, and the prohibitions are subject to definitions, ten specific exceptions, and a sweeping exception that leaves it up to the SEC and other agencies to decide what should be an exception. For example, a "banking entity" is a defined term. He found it interesting that Lazard, in their earlier presentation to the Board, clearly stated that they were not a bank but an intellectual information institution -- which he would say falls outside the definition of a banking entity. It will all take time to sort out; the rules respecting the proxy provision are being challenged as inappropriate because it violates the constitutional mandate that the legislature enact statutes and delegates too much to the executive branch.

MR. JOHNSON briefly reviewed the ten subtitles of Title IX - Investor Protections and Improvements to Regulations of Securities. He had included an appendix that had comments from Morgan Stanley about the unintended consequences of the margin requirements. He zeroed in on the proxy provisions as an area of interest and explained some of those.

MR. PIHL asked if the Dodd-Frank Act regulations would apply to a foreign-owned bank. When MR. JOHNSON said no, that he thought that was one of the exceptions to the Volcker Act, MR. PIHL mused that the result could be that banks all become foreign-owned.

MR. O'LEARY observed that people are acting on the expectations of the law. One effect has been a record number of hedge fund start-ups where people had previously been proprietary traders at investment banking firms. A significant dollar amount of some investment banks' balance sheets was invested in deals that they invested in, and they know that they will not be able to do that in the future to the same degree. That will have significant business implications for those firms. Also, there will be great opportunities to access some very high quality people who previously worked as a profitable entity within an organization.

MR. JOHNSON said another consequence may be that banks get back to the business of lending, such as was mentioned in the private equity presentation earlier, and pay greater attention to due diligence so the country does not face the prospects of another subprime crisis.

VICE CHAIR TRIVETTE thanked Mr. Johnson for his presentation. He remarked that he had dozens of questions while reviewing the written material from legal counsel, but he realized that it did not warrant spending any time on because the rules and regulations for the Act were so far away from being created.

VICE CHAIR TRIVETTE mentioned that the Board was losing two of its members this week, and he wanted to thank Commissioner Kreitzer and Commissioner Galvin for their service and dedication to the Alaska Retirement Management Board. He said Commissioner Galvin also brought a unique perspective because of his service on the Alaska Permanent Fund Corporation Board of Trustees.

Trustees and staff gave a standing ovation to the two departing Board trustees.

COMMISSIONER GALVIN said he appreciated the opportunity to serve on the Board and that it was a great experience to see what goes on on the benefit side, along with the investment side. He said the experiment that is this Board, in terms of merging the investment side and the benefit side, was going along quite well. He thought it was an important role to balance those two things, and the Board had an opportunity to continue looking for ways to marry those two concepts. Struggling with those responsibilities would be an ongoing challenge, and the Study Group has already been at work in that regard. He urged his fellow trustees to continue viewing the ARMB as an experiment, because they had the opportunity to reinvent the Board as it moved forward.

RECESS FOR THE DAY

VICE CHAIR TRIVETTE recessed the meeting for the day at 4:51 p.m.

Friday, December 3, 2010

CALL BACK TO ORDER

CHAIR SCHUBERT called the meeting back to order at 9:04 a.m. She apologized for missing the first day so she could attend the Alaska Federation of Natives meeting. She said she was a strong supporter of Governor Parnell and stayed later to hear him speak, and he had some really good things to say.

REPORTS (Continued)

15. TCW Energy Fund Report

BLAIR THOMAS and CLAUDIA SCHLOSS of TWC Energy and Infrastructure Group (EIG) gave a report on Energy Fund XV. MS. SCHLOSS said the ARMB had invested in Fund X and Fund XIV, and Fund XV was up for the Board's approval to recommit. *[A copy of TCW's slides is on file at the ARMB office.]*

MR. THOMAS provided details on the ARMB's $80 million commitment to Energy Fund X and the $100 million commitment to Energy Fund XIV. He then explained that Fund XIV is a little stronger than Fund X because EIG's defensive style means they tend to do better in choppier markets -- and so the performance has been outstanding in light of what has happened in the markets since 2007. The market remains very good for the type of investing that they do.

MR. THOMAS highlighted five characteristics that EIG believes distinguish them from others in the marketplace:

- Their 28-year track record as an institutional investor in the energy sector and having invested over $11 billion over that time period.
- The technical capability of the professionals in the group, which is important because they are investing in hard assets that are also illiquid assets with an average life of just over six years.
- They have the most global platform of any of the institutional investors in energy; 45% of EIG's investment activity over the last three years has been outside the United States, and that continues to grow. Such geographic diversification lowers the risk profile of the fund.
- Their target market is energy broadly defined, all the way from the well head to the point where electricity is sold. EIG employs subsector diversification to dampen the volatility inherent in the energy sector.
- Their focus on preservation of capital. They have both a debt component and an equity component to almost every investment they make, providing a strong current yield in the portfolio plus an equity kicker.

MR. THOMAS explained the math behind their defaulted investments over 28 years to illustrate that if every "mistake" in their history were put into a single portfolio and invested in, an investor would get their capital back and a 7% rate of return. He said EIG's style has delivered a consistency of returns that none of their competitors can match. While people tend to undervalue risk in raging bull markets, risk has been re-injected back into the equation in the last couple of years, and suddenly risk-adjusted returns matter again. That is where EIG Energy shines.

MR. THOMAS also talked about EIG's style being conducive to producing a strong cash flow for investors and how that was borne out in Fund XIV that closed in December 2007 and that has made a distribution every quarter since then, even through the worst financial crisis in some time.

MR. THOMAS spoke briefly about Energy Fund XV that was launched in February and is a clone of Fund XIV. EIG has had a lot of success with it so far, having invested $195 million already and having a robust pipeline of transactions. He said energy is a sector that institutional investors around the world are looking to increase exposure to because it is both hard assets and has an inflation element to it.

Responding to MR. O'LEARY's inquiry, MR. THOMAS stated that TCW is going through some challenges right now that he thought were largely related to generational succession. He said TCW is getting back to a marketable securities firm (stocks and bonds). The two large alternative products at TCW -- the energy group and the buyout mezzanine group -- both did consensual spinouts in the last year, with TCW maintaining a residual economic interest in the businesses. TCW Energy and Infrastructure Group is operationally independent, and every person on the team stayed with the team.

At MR. RICHARD's request, MR. THOMAS explained the purpose of opening up 15 different funds, why there are only two of the funds still active, X and XIV, and the purpose for currently raising capital for the next follow-on fund. He stressed that there is no competition among the funds, and all 52 people in the firm are focused on Fund XV. He added that they have resisted any pressure over the years to expand the business into other opportunities like infrastructure and resources, etc. because they believe they are a niche investor and they want to continue their singular focus where they have a great track record. TCW EIG is large enough to be relevant to the big energy companies that they work with, but they are not so large that they become the market.

CHAIR SCHUBERT thanked the TCW Energy Group representatives for the presentation.

16. Brandes Investment Partners - DCR and DB Mandates

GLENN CARLSON and JUAN BENITO joined the meeting to present a report on the two international equity portfolios that Brandes manages for the State of Alaska defined benefit plan and the defined contribution plan. *[A copy of the Brandes slide presentation is on file* *at the ARMB office.]*

MR. BENITO showed a slide of the performance for the larger and older fund for the defined benefit plan, saying the long-term performance has been good, but recent returns have not been stellar, barely breaking even with the benchmark last year. The portfolio for the defined contribution plan was transferred from a mutual fund to a collective investment trust a year ago and has a shorter history. The collective investment trust has the advantages of providing daily pricing and lower management fees for the participants.

MR. CARLSON presented a graph of the composite international portfolio return since 1993, noting there have been times when Brandes has done very well and periods when they have done poorly. MR. BENITO added that a Brandes Institute study of all types of equity managers showed that there have been no long-term outperformers that have not underperformed in the short term.

MR. CARLSON described what Brandes is optimistic about. The portfolios are at a substantial discount relative to the index on a price-to-book-value ratio, a substantial discount on a P/E ratio and price-to-cash flow ratio, and a substantial premium in terms of dividend yield. That does not indicate that Brandes will outperform or not, but it puts the odds in their favor to a certain extent. They are not buying companies that are under great stress; they are buying businesses that have very strong balance sheets and strong competitive positions, and they are getting them at very attractive prices.

MR. CARLSON explained the key overweights in the portfolios: diversified telecommunication services, pharmaceuticals, and individual businesses in Japan that are trading at prices not seen for 30 years. He said a Morgan Stanley Japanese strategist wrote an interesting piece on a cyclically adjusted P/E ratio, which is looking at the P/Es smoothed out over a long period of time and adjusted for inflation as a truer estimate of what sustainable earnings are for businesses and as a guide for when to invest or when not to invest.

MR. CARLSON mentioned that the portfolios have been tracking the benchmarks pretty closely, even though they are weighted very differently than the benchmark. The issue is that for a number of years the correlations got very high (some suggest a 60-year high), meaning all the markets have been behaving the same. If people are worried about cataclysmic events all the time, they are going to buy and sell based upon the news, and it does not matter what stocks are in the portfolio. But the world is starting to settle down, and Brandes believes they will start to see less correlation going forward and a greater spread from the benchmark.

MR. BENITO briefly reviewed the Brandes investment philosophy centered around value investing, and how most of the partners are analysts -- because if analysts get the valuations right on how much companies are worth, good things will happen to the portfolio. He also stated that the firm was employee-owned and remaining stable even through the difficult markets. He noted that many of their products had been closed for as long as ten years, but they reopened some products when private clients withdrew money during the market decline and created a little capacity.

MR. BADER informed the Board that Ryan Bigelow of the ARMB investment staff worked very hard with Brandes to get greater transparency and lower fees in the international equity portfolio, which was a substantial accomplishment. He wanted to recognize Mr. Bigelow for his efforts in what Brandes described as a very smooth transition process to the collective investment trust for the defined contribution plan participants.

MR. BENITO stated that a small difference in the ARMB's performance over the index adds up over time. He added that the Board has made good decisions in putting money into the international equity portfolio in the [market cycle] valleys and taking money out at the peaks. Add to that what Brandes has done, and the result is that net contribution to the portfolio is $77 million, but the portfolio is worth $871 million.

MR. BENITO briefly reviewed the sector exposure in the portfolio, saying that telecommunications, information technology, and health care are large overweights, and materials, industrials, and utilities are very large underweights. He noted that materials and commodities are at the peak or in a bubble, and Brandes is not going to find cheap companies there. Conversely, they are finding telecommunications and information technology opportunities in Japan.

MR. O'LEARY asked about the emerging markets exposure in the portfolio, which was once north of 20% but is currently at 7%. He also wondered if Brandes restricted capacity in developed market types of accounts for use for those who want to focus on emerging markets.

MR. CARLSON replied that Brandes does not restrict at all exposure to their larger portfolios into emerging markets based upon a desire to retain capacity for the stand-alone emerging markets portfolio. They believe their emerging markets stand-alone portfolio has quite limited capacity, and the reason why they want to limit the capacity is to give them the opportunity, when it presents itself, to be in their large cap products. It turns out in their emerging markets offering for the last few years they have not found great value in the large cap space in emerging markets. Where they find opportunities in the stand-alone emerging market product is the small and mid cap space, and that is where they have been for quite some time. That, in itself, restricts capacity.

Regarding what Brandes thinks about non-index exposure, MR. CARLSON stated that if there are opportunities, and the ARMB will allow them to go there, they have been willing to go up to 20% outside the EAFE in emerging markets exposure. Brandes was close to 20% in emerging markets in the late 1990s and early 2000s because other people hated it then, which presented good opportunities for Brandes. He acknowledged that the ARMB does not restrict them to developed markets.

MR. BENITO stated that the only restriction is self-imposed for the product at large, which is no higher than 30% in emerging markets if the opportunities are there. Right now they are at 7% because the opportunities are not there.

MR. TRIVETTE requested the research on the concept of cyclically adjusted P/E ratio that Mr. Carlson mentioned. MR. CARLSON indicated he would forward it to Mr. Bader.

CHAIR SCHUBERT thanked the gentlemen for their presentation and then called a scheduled break from 10:07 a.m. to 10:23 a.m.

17. State Street Global Advisors (all mandates)

NEIL TREMBLAY, the relationship manager for State Street Global Advisors, introduced LYNN BLAKE and ERIC BRANDHORST of the Global Structured Products Group at State Street. He said Ms. Blake would be taking over from Paul Brakke as head of the group when he retired at the end of the year. *[A copy of the State Street presentation slides and backup material is on file at the ARMB office.]*

MR. TREMBLAY gave a quick overview of the firm, saying the State Street Corporation did a restructuring yesterday that focused on three areas: (1) a substantial investment in technology between 2011 and 2014 to increase efficiency and reduce costs; (2) looking at their facilities worldwide to determine which centers can best support their internal and external functions; and (3) reduce the workforce by roughly 5%, or 1,400 people, through 2011. State Street Global Advisors (SSgA) will experience a staff reduction of about 3%, or 65 people, throughout the year. There has been no change in the groups servicing the Alaska accounts, and they do not anticipate any changes in the portfolio management groups. The strategic plans for SSgA have been unaffected by the restructuring; they will continue to hire across the board to support their initiatives.

MR. TREMBLAY described the four key initiatives of SSgA:

- Continue to support both the passive and active investment options or processes, and that will include acquisitions (SSgA recently acquired the Bank of Ireland's investment management business).
- Focus on expanding the defined contribution business to provide not only investment options but also participant education and participant communication materials to assist clients, and to research participant behavior.
- Exchange traded funds.
- Cash - they are one of the largest cash management organizations in the world, and they see opportunity there.

MR. TREMBLAY reviewed their global footprint and investment platform, and assets under management.

He also reported that SSgA manages $3.1 billion of retirement assets for the State of Alaska; about $2.7 billion is defined benefit plan assets and roughly $438 million is defined contribution plan assets. The retirement assets are managed in eight different strategies, all of them passive strategies. As a risk control measure, SSgA also has a mandate to be the backup for the State's internally managed fixed income assets if anything were to happen to the fixed income group.

MR. TREMBLAY reported that SSgA manages non-retirement assets totaling $3.5 billion for various state agencies and the University of Alaska. For the total combined retirement and non-retirement assets of $6.832 billion that SSgA manages for the State of Alaska, the average investment management fee is 2.62 basis points.

MR. TREMBLAY presented the performance for the six separate account index funds in the defined benefit and defined contribution plans. He said each strategy performed within expectations, with the exception of the Russell 2000 Growth Strategy, which underperformed in a window between February 2009 and February 2010. That was primarily due to the assets falling from roughly $87 million down to $37 million and then down to between $6 million and $13 million during that timeframe. The average tracking error to the benchmark index had been positive four basis points up until February 2009, but in the next year the average monthly tracking error was roughly minus 16 basis points. Since then, the assets have come back up to about $100 million, and tracking has been virtually spot on. The biggest issue when assets are low is that SSgA has to try to replicate the index but without owning all the securities within the Russell 2000 Growth Index. After March 2009 the market took off, and there was a penalty for not owning all the securities in the index.

MR. TREMBLAY explained that from time to time SSgA runs into circumstances where cash flows adversely affect the portfolios. They have talked to ARMB staff about the potential of using futures for cash equitization within the portfolio, which would help reduce the cash drag and also the drag associated with receivables in the portfolios themselves -- meaning they could more closely track the benchmark.

MR. TRIVETTE asked about the ups and downs of using futures. MS. BLAKE said SSgA uses exchange-traded futures (ETFs), which are very liquid and cost-effective. And, for the most part, they track the underlying index pretty closely. It is a very effective way to raise cash but still maintain the equity exposure until the cash moves out of the portfolio. She emphasized that they would never use leverage, but ETFs have 100% exposure against a chosen index, and they would want that exposure if the markets are moving up.

MR. BADER informed the Board that staff would probably bring an action item on the ability to use futures in transactions at the next meeting.

MR. TREMBLAY presented the performance for the eight index funds in the defined contribution plans, noting that all the strategies are performing within expectations. He added that the REIT Index strategy has a bit more tracking error than most because SSgA typically has to hold more cash than they would like in order to fund the daily participant cash flows in and out of the fund, and there are no futures to cover REITs.

MR. TREMBLAY reported that the two strategies for the non-retirement assets were tracking according to expectations with no real issues. The same was true for the University of Alaska assets. He joked that if it is an exciting presentation when talking about passive management, then there is a problem -- and they like to keep it as boring as possible.

MS. BLAKE, as the incoming head of the Global Structured Products Group, spent some time talking about the group, the structure, what strategies they manage, how they are managing the strategies, the infrastructure in place to support relationships and operations, and the risk controls used. MR. BRANDHORST explained the research they are doing with regard to traditional beta strategies and alternative beta strategies. MS. BLAKE and MR. BRANDHORST took questions from MR. O'LEARY and MR. BADER and others throughout this presentation. *[For details on this part of the SSgA presentation, please refer to the verbatim transcript on file at the ARMB office.]*

MR. BADER mentioned that he had difficulty reconciling the growth in assets under management over the past few years with SSgA's decrease in staff, because his observation is that it has impacted the client. He said he told this directly to Jay Hooley, State Street Corporation's president and CEO, but he wanted to convey the message that their being able to provide the same level of service was something of continuing concern to people who have to deal with staff.

MS. BLAKE responded that the layoffs and decrease in staff that impacted SSgA have been very focused in areas where they are not growing or are overstaffed. Her team has not had any impact due to layoffs over the last three years; in fact, they continue to hire new portfolio managers. She could not comment on the overall corporation, but she thought those layoffs were also focused on certain areas where there is overstaffing.

MR. TRIVETTE said he echoed Mr. Bader's comment and thought the firm's expectation of getting another $90 billion in assets for them to keep track of this year was mind-boggling. He said the Board gets rebalancing reports from Mr. Bader at every meeting about money being transferred around, and most of it is going through State Street. They might have the best computers in the world, but the business is still human-being intensive. His concern was if State Street could continue to do that without adding significantly more people.

MS. BLAKE stated that in addition to the two portfolio managers hired recently, there are three open portfolio manager positions that have been budgeted in the expenses. So the growth in staff for the Global Structured Products Group is, to a large degree, because they have grown so significantly as an investment strategy. But coinciding with that, they continue to develop efficiencies and automate where they can. A lot of the growth in assets comes from participant cash flow into existing commingled funds, which does not create any additional work to manage those assets, at least on the portfolio management side. As a firm with $750 billion under management and very large cash flows, a lot of what they have to focus on is minimizing operating risk.

At the end of MR. BRANDHORST's discussion of alternative beta strategies, MR. O'LEARY reiterated one of the important points about the Board owning the decision to invest in a particular strategy. He also said that policy risk is maybe the biggest risk: can the Board maintain a policy when it does not seem to be working? He cited the predecessor board that had a value tilt in the policy for many years, and during a period when value was not rewarded the board had the opportunity to take that tilt off right before the bubble burst and right before value produced the excess returns.

At 12:00 p.m., CHAIR SCHUBERT thanked the people from SSgA for their presentation and recessed the meeting for the scheduled lunch break. She called the meeting back to order at 1:19 p.m.

18. Investment Actions

18(a). Absolute Return Rebalance

MR. BADER reviewed the staff report in the packet *[on file]*. He added that it was the consensus at the Manager Review meeting in October that there should be a rebalancing of the absolute return managers. Staff was requesting to increase the amount of money to Global Asset Management and Prisma Capital Partners and to reduce Mariner Investment Group and Crestline Investors, which should bring them all closer to balance and improve the risk characteristics of the absolute return portfolio.

<u>MS. HARBO moved that the Alaska Retirement Management Board direct staff to rebalance the absolute return portfolio as described</u>. <u>Second by MR. TRIVETTE</u>. The motion carried unanimously.

18(b). State Street Global Advisors Fixed Income Backup Contract

MR. BADER reviewed the staff report in the packet *[on file]*, and the recommendation to add the TIPS portfolio and the intermediate treasury portfolio to the contract for SSgA to run the fixed income portfolios in the event that internal staff could not do so.

<u>MR. PIHL moved that the Alaska Retirement Management board approve an amendment to the original agreement with State Street Global Advisors as backup fixed income</u>

portfolio manager, reflecting the changing fixed income mandates managed by staff. MR. RICHARDS seconded. The motion passed unanimously.

18(c). Mondrian Contract Amendment

MR. BADER reviewed the staff report in the packet *[on file]* regarding expanding Mondrian's current mandate of managing a developed markets international fixed income portfolio to use a blended benchmark of 70% Citigroup World Government Bond Index and 30% JP Morgan Government Bond Index-Emerging Markets Broad Diversified Index so they can include local currency emerging market debt, and to alter the existing constraints on country exposures to be consistent with managing a portfolio to this blended index. Staff was also asking for authorization to initiate the registration process to allow for direct investment into the necessary set of countries for which the ARMB has not registered and to allow Mondrian to invest in the firm's commingled emerging market debt commingled vehicle until such time as the ARMB is registered in the necessary countries to effect this strategy on a separate account basis.

MR. RICHARDS moved that the ARMB approve staff's request to amend the Mondrian contract as described. MS. HARBO seconded. The motion carried unanimously.

18(d). Real Estate Committee

MR. BADER reviewed the staff report in the packet *[on file]* and the recommendation to rename the committee and have it review all investment strategies within the real assets asset class (timber, farmland, energy, TIPS, and real estate). He said staff would come back to the Board and the committee with revised guidelines and other details to accompany such a change.

MR. TRIVETTE moved that the ARMB approve renaming the Real Estate Committee to the Real Assets Committee and include a review of all investment strategies within the real assets asset class. Seconded by MS. HARBO. The motion passed unanimously.

18(e). Energy Fund Allocation

MR. BADER reviewed the staff report in the packet *[on file]* and the recommendation to invest in Energy and Infrastructure Group Energy Fund XV. He noted that the ARMB has invested in two previous funds and has had double-digit internal rates of return to date.

MR. WILLIAMS moved that the Alaska Retirement Management Board commit $50 million to EIG Energy Fund XV, subject to the satisfactory completion of due diligence and negotiation. MR. PIHL seconded.

DR. JENNINGS expressed support for energy as an important asset category for the ARMB portfolio, and said the retirement fund has had good experience with the manager. He recommended that the Real Assets Committee think about a specific target for a private energy allocation. A non-profit he works with has a small allocation of 2%, separate from other real assets and separate from private equity. In setting any such target, he encouraged thinking about the importance of energy to the state, as well as about the energy investments in the existing private equity portfolio. If the Board decided it wanted a separate target for energy, he suggested manager diversification as it built out the allocation. Further, a separate suballocation should probably have a plan on how to get to whatever target was set, basically a smaller version of the private equity plan.

MR. TRIVETTE asked if the consultant or advisor had any problem with what TCW Energy discussed in their presentation. MR. O'LEARY said no, that TCW's had been a very cordial change in structure, that TCW had a deep interest in seeing the Energy and Infrastructure Group be successful, and the principals had a great incentive to continue making investments that will be as profitable.

Further responding to MR. TRIVETTE, MR. BADER said that the first investment with TCW was $80 million and the second was $100 million. In consultation with Mr. Hanna, they both agreed that $50 million was an appropriate target for Fund XV so it did not expand the actual money invested in this asset category by too great an amount.

The motion passed unanimously.

18(f). U.S. Intermediate Treasury Guidelines - Resolution 2010-19
MR. BADER reviewed the staff report in the packet *[on file]*. MR. MITCHELL had also covered the reasons for the two recommended changes to the investment guidelines in his earlier report on fixed income: (1) to remove the 5% restriction on securities that are not full faith and credit obligations of the U.S. government; and (2) remove the requirement that a U.S. government or treasury security be a coupon-paying security.

<u>MR. TRIVETTE moved that the Alaska Retirement Management Board adopt Resolution 2010-19 approving changes in the Intermediate U.S. Treasury Fixed Income Guidelines, as indicated in the redlined version provided in the meeting packet</u>. <u>MS. HARBO seconded</u>. The motion passed unanimously.

18(g). Rebalancing - Resolution 2010-20
MR. BADER reviewed the staff report in the packet *[on file]*, wherein staff requested the authority for the chief investment officer to rebalance the portfolio within the bands that the Board has approved for the asset allocation. He explained that a strict read of the existing rebalancing policy indicates that the CIO should only rebalance when an asset class is out of balance. That can be inconvenient because some managers are only open for transactions at the beginning or end of the month. The second point is that staff would prefer to be proactive and not let asset classes get out of balance. Third, staff believes there is a possibility, if given the authority, that they would lower the current actual allocation to fixed income in the current interest rate environment and that the retirement fund would be far better off in other fixed income or other asset classes.

MR. TRIVETTE moved that the Alaska Retirement Management Board adopt Resolution 2010-20, modifying the existing rebalancing policy. Seconded by MS. HARBO.

MR. RICHARDS inquired about tightening up the last sentence of the resolution to say the CIO would advise the Board at the next regularly scheduled meeting of changes pertaining to this resolution. MR. TRIVETTE suggested adding something along the lines of ..."the CIO will advise the Board of the rebalancing." MR. RICHARDS said he was fine with that. MS. HARBO, as the second to the motion, had no objection to the proposed amendment.

CHAIR SCHUBERT said the second to last sentence would read, "The CIO will advise the Board of the rebalancing at its next regularly scheduled meeting."

The motion carried unanimously.

18(h). Delegation of Authority - Resolution 2010-21

MR. BADER reviewed the staff report in the packet *[on file]* requesting authority to remove the 25% limit on the chief investment officer's ability to invest or divest from an existing investment manager. He said this has not been a problem in the past, but one thing staff has in mind is allocating more money to Advent Securities, the convertible bond manager, where the initial allocation was not very large. Staff believes the ARMB can get a higher yield and better diversification of the portfolio.

MR. PIHL observed that the resolution specifically used the CIO's name instead of the position, so he wondered if the resolution would continue after Mr. Bader retired.

MR. BADER indicated that staff could strike the name reference.

MR. PIHL moved that the ARM Board adopt Resolution 2010-21, modifying the authority of the CIO to invest or divest from an existing investment manager. MR. RICHARDS seconded. The motion carried unanimously.

19(a). Actuarial Valuation Assumption Changes

[A packet of memoranda and resolutions prepared by the Department of Administration, Division of Retirement and Benefits, was distributed to trustees ahead of time, and is on file at the ARMB office.]

COMMISSIONER KREITZER said the first item was informational. The commissioner of the Department of Administration sets the employer contribution rate for the Judicial Retirement System (JRS). The FY12 employer contribution rate has been set at 29.79%, which is the normal cost rate for FY12, with the understanding that the Department of Administration is going to ask for a direct appropriation for the past service rate cost of about $2.3 million for FY12.

COMMISSIONER KREITZER said the Department of Administration consulted with the Department of Law, and Law's opinion has morphed a bit so that they want the Board to adopt the valuation assumptions, as well as the actuarial experience analysis for JRS, but not the contribution rate.

COMMISSIONER KREITZER moved adoption of Resolution 2010-22, relating to the actuarial experience analysis for the Judicial Retirement System. MS. HARBO seconded.

When MR. TRIVETTE questioned if the Board had that authority, MR. JOHNSON said Law's was a reasonable reading of the statutes, and he suggested going forward with the proposed action item as recommended. He added that there is a distinction between setting the contribution rates, which the commissioner does, and the Board's authority to accept the actuarial assumptions in the report.

The motion passed unanimously.

MR. PIHL mentioned legislation to change the rate setting responsibility for JRS from the commissioner to the ARMB. COMMISSIONER KREITZER said the department kept looking for an opportunity to attempt that but they have not found a vehicle to make that change yet.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board adopt assumptions to future actuarial valuations based on the actuarial experience analysis as of June 30, 2008 prepared by Buck Consultants for the Judicial Retirement System, as set out in Resolution 2010-23. MS. HARBO seconded. The motion passed unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board accept the roll-forward actuarial valuation report prepared by Buck Consultants for the National Guard and Naval Militia Retirement System as of June 30, 2009 in order to set the actuarially determined contribution rates, as set out in Resolution 2010-24. MS. HARBO seconded. The motion carried unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board set the fiscal year 2012 National Guard and Naval Militia Retirement System annual actuarially determined contribution amount consistent with its fiduciary duty, as set out in Resolution 2010-25. Seconded by MS. HARBO. The motion passed unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board accept the actuarial experience analysis as of June 30, 2008 prepared by Buck Consultants for the National Guard and Naval Militia Retirement System in order to adopt assumptions for future actuarial valuations, as set out in Resolution 2010-26. Seconded by

MS. HARBO.

There was a brief discussion about the NGNMRS experience analysis as of June 30, 2008 being used for the FY13 contribution calculation, and if that should be spelled out in Resolution 2010-26. DEPUTY COMMISSIONER BROOKS said that was a good suggestion for the following resolution, 2010-27.

The motion passed unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board approve and adopt assumption changes contained in the National Guard and Naval Militia Retirement System actuarial experience study prepared by Buck Consultants for use beginning with the June 30, 2010 NGNMRS actuarial valuation report, for the purpose of establishing the FY13 contribution amount, as set out in Resolution 2010-27. MS. HARBO seconded. The motion passed unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board accept the actuarial experience analysis as of June 30, 2009 prepared by Buck Consultants for the Public Employees' and Teachers' Defined Contribution Retirement System in order to adopt assumptions for future actuarial valuations, as set forth in Resolution 2010-28. MS. HARBO seconded. The motion carried unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board adopt the actuarial valuation assumptions for the Public Employees' and Teachers' Defined Contribution Retirement Systems based on the actuarial experience analysis as of June 30, 2009 prepared by Buck Consultants, as set out in Resolution 2010-29. MS. HARBO seconded.

COMMISSIONER KREITZER noted that Resolution 2010-31 to follow would have two recommended changes to the assumptions adopted in Resolution 2010-29: a 4.88% real rate of return expectation and a 3.12% inflation rate.

MS. ERCHINGER said it was her understanding that the Study Group agreed to recommend that the Board accept Buck's recommendation to move towards the unisex assumptions because there is no material difference in how males and females should be treated for termination, retirement, and turnover. But the Study Group asked that Buck be prepared to share with the second actuary, Gabriel Roeder Smith & Company (GRS), the data they used to come up with their recommendation. GRS appeared to disagree that the use of unisex assumptions was an industry standard.

MS. ERCHINGER stated that there was no consensus between Buck and GRS as to the retiree health care assumption. Buck explained to the Study Group why they did not want to change the health care assumption, despite there being five years in a row of persistent health care gains. Buck reasoned that the trend rates they were using for retiree health care costs were very low compared to national norms and other Alaska plans and that it was appropriate to continue using those same assumptions. The Study Group agreed with Buck to continue with those until there was compelling information one way or another.

MS. ERCHINGER added that Buck and GRS also did not agree on the assumption for withdrawal of contributions at retirement, where Buck was using a 10% assumption for TRS. Buck felt there were few numbers to go by, and they were confident in their assumption. The Study Group agreed to continue with Buck's current assumption.

MR. TRIVETTE remarked that he preferred to have had the minutes of the November 18-19 Study Group meeting so he could refer to them and so people who were not there could read what went on. He added that part of the discussion also took place at the September 23-24 meeting; the trustees did not have those minutes either, but he would have liked to have read those before the Board made any final decisions.

COMMISSIONER KREITZER stated that Trustee Erchinger did a fabulous job of summarizing the Study Group's recommendations. She added that the Division of Retirement and Benefits was tasked with bringing the recommendation to the Board. She noted that Resolution 2010-29 was for the PERS and TRS defined contribution plan actuarial valuation assumptions [and another resolution was for the defined benefit plans].

A discussion ensued about whether the PERS and TRS assumptions should be the same for the defined contribution plans and the defined benefit plans or separate. *[For details please refer to the verbatim transcript of the meeting, pages 348-362.]*

CHAIR SCHUBERT summarized the discussion and read into the record an amended last paragraph of Resolution 2010-29, as follows: "NOW THEREFORE, BE IT RESOLVED BY THE ALASKA RETIREMENT MANAGEMENT BOARD, that the recommendations for assumption changes contained in the defined contribution actuarial experience analysis for the Public Employees' Retirement System and Teachers' Retirement System prepared by Buck Consultants be approved and adopted for use beginning with the June 30, 2010 PERS and TRS DCR actuarial valuation report."

COMMISSIONER KREITZER, as maker of the original motion, and MS. HARBO, as the second, had no objection. The motion, as amended, passed unanimously.

<u>COMMISSIONER KREITZER moved that the Alaska Retirement Management Board adopt Resolution 2010-30, to approve and adopt the Public Employees' Retirement System and the Teachers' Retirement System actuarial experience analysis as of June 30, 2009 prepared by Buck Consultants</u>. <u>MS. HARBO seconded</u>.

MR. TRIVETTE voiced skepticism about the words "approve and adopt," saying that he thought it was more accurate to say the Board was accepting the experience analysis report.

COMMISSIONER KREITZER suggested amending the "Now Therefore" clause of Resolution 2010-30 to strike the last two words ("and adopted") and end it after the words "be approved."

There was no objection, and the motion passed unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board adopt assumptions for future actuarial valuations based on the actuarial experience analysis for the period July 1, 2005 to June 30, 2009 prepared by Buck Consultants for the Public Employees' and Teachers' Retirement Systems, including a Board-requested modification of Section II A (Economic Assumptions - Investment Return or Interest Rate) and Section II B (Economic Assumptions - Inflation) as set out in the attached Resolution 2010-31 and as follows:

Section II A. 4.88% real rate of return expectation

Section II B. 3.12% inflation rate

The result of which will be a net rate of return expectation of 8.0%. MS. HARBO seconded.

MR. PIHL stated that he totally supported this action, that it was a step in the right direction.

MS. ERCHINGER asked if the resolution meant that Buck Consultants would go back and rerun the June 30, 2010 valuation report using the new assumptions. MR. SHIER stated that the June 30, 2010 report would be used for the FY13 rate setting, but Buck had not even shown the Division a draft yet.

CHAIR SCHUBERT suggested amending the last paragraph of Resolution 2010-31 to reflect the adoption that was not captured in Resolution 2010-30, as follows: "NOW THEREFORE, BE IT RESOLVED BY THE ALASKA RETIREMENT MANAGEMENT BOARD that the recommendations for assumption changes contained in the Public Employees' Retirement System and Teachers' Retirement System actuarial experience analysis as of June 30, 2009 prepared by Buck Consultants be approved and adopted for use beginning with the June 30, 2010 PERS and TRS actuarial valuation report, except that Section II A (Economic Assumptions - Investment Return or Interest Rate) and Section II B (Economic Assumptions - Inflation) are modified as follows:

Section II A. 4.88% real rate of return expectation

Section II B. 3.12% inflation rate

The result of which will be a net rate of return expectation of 8.0%.

MR. PIHL stated that the word "net" should not be in the last line. CHAIR SCHUBERT asked if the maker and the second on the motion objected: they did not.

The motion, as amended, passed unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board adopt Resolution 2010-32 relating to the FY12 employer contribution rate for the Public Employees' Retirement System. MS. HARBO seconded. The motion carried unanimously.

COMMISSIONER KREITZER moved that the Alaska Retirement Management Board adopt Resolution 2010-33 relating to the FY12 employer contribution rate for the Teachers' Retirement System. MS. HARBO seconded. The motion carried unanimously.

MS. ERCHINGER asked that the record reflect that the Board was changing the contribution rates adopted at the June meeting. MR. SHIER said David Teal of the Legislative Audit Division had testified at the April Board meeting about the complexity of calculating the Senate Bill 125 State contribution. The actuary concurred that it would be more straightforward to simply state the DCR contribution as a percent of total payroll, the normal cost, and add that into the total rate. At the April meeting, Buck presented the actuarial contribution rate for the PERS defined benefit plan at 30.76%. The DCR normal cost as a percent of total payroll was 2.73%. Added together, the total was 33.49%. Buck presented the actuarial contribution rate for the TRS defined benefit plan at 42.61%. The DCR contribution normal cost to TRS as a percent of total payroll was 2.94%. Added together, the result was 45.55%.

MR. SHIER said he would have a follow-up in writing at the next meeting on Buck and GRS and adoption of the unisex assumptions.

There was an at-ease from 2:54 p.m. to 3:04 p.m. while staff assembled the slides needed for the next presentation.

MS. ERCHINGER moved reconsideration of Resolution 2010-29. MS. HARBO seconded.

MS. ERCHINGER said she wanted to make sure everyone was on the same page and to get additional input from the Departments of Revenue and Administration, specifically about the benefits of using the same investment assumption and inflation assumption [for the DB and DCR plans]. Her intent was to bring this back at the next meeting.

COMMISSIONER KREITZER said she appreciated the reconsideration because her department did not see any models at the work session about what that would look like in the defined contribution plan, and she wanted to come back to the Board with that information.

The motion passed unanimously.

MS. ERCHINGER moved to table Resolution 2010-29 until the next meeting. MR. TRIVETTE seconded. The motion carried unanimously.

19(b). Report of Trustee Study Group on Actuarial Issues

[Please refer to the verbatim transcript, pages 373-405, for details of this report and the discussion that followed.]

MR. PIHL, Chair of the Trustee Study Group that met November 18-19 to address long-range unfunded liability issues and related actuarial assumptions, said the group had requested several charts and analysis from Buck Consultants and the Division of Retirement and Benefits, some of which he had received and some that were still forthcoming.

MR. PIHL spent some time summarizing what the Study Group tackled during the two days:

- The problem of the retirement systems' unfunded liability shared among the State (as sponsor), the Administration, the municipalities, and the legislators who negotiated the plan.
- The State's responsibility to pay a portion of the unfunded liability.
- The Supreme Court decisions.
- A 20-year history of investment returns, employer contribution rates, and State assistance.
- The legislation dealing with the employer contributions on defined contribution plans and defined benefit plans.
- That the size of the unfunded liability was aggravated by the 2008-2009 market crash.
- Legislative intent in structuring the plan to stop the snowballing of the unfunded liability and to amortize it over time.

MR. PIHL reviewed three schedules he had requested and received *[on file at the ARMB office]*, one of which he used to illustrate that extending payments out over a longer period of time was going to cost the State a lot more in the end.

MS. ERCHINGER stated that she supported a solution to the problem that was a partnership between the municipalities and the State, because the unfunded liability is a big bill to pay and there are no winners in this situation. The current path is not affordable for the State in 15 years, but she wanted to make sure the municipalities did not get stuck with higher contribution rates than the current 22%.

MR. PIHL remarked that the Study Group agenda had a fact-finding part and a second part to look at various scenarios and solutions. The question on the second part was whether some of the solutions, like the use of pension obligation bonds, were really within the purview of the Board.

COMMISSIONER KREITZER stated that the Study Group was a very good effort to bridge the gaps between the Legislature, the ARMB, and the Governor's Office in looking at solutions proposed by various agencies and individuals and trying to inch toward a recommendation of where to go from here.

MS. ERCHINGER said there were extreme sides of the argument on both ends, and then a lot of people fell somewhere in the middle. A primary question was whether this Board should do anything, do nothing, or do something in the middle. Extending the amortization period for paying off the unfunded liability was one thing talked about, and the scenarios varied there, as did people's reactions to the number of years over which to amortize. What did not get discussed was the cost over time for the various amortization scenarios. The Study Group reached consensus on amending the inflation assumption and earnings assumption, which was a significant accomplishment. The Group also talked about whether the Board would be willing to consider levelized annual payments.

MR. RICHARDS thanked Mr. Pihl and Ms. Erchinger for an excellent summary of the major points from the two-day work session. He pointed out that the other people at the table are the PERS and TRS retirees, who are quite concerned about the unfunded liability. The Board must not forget that it is here to make sure there is secure retirement for the people who have worked very hard for their employers and their students. He said he felt like the Board was in a bit of a negotiation with the State, and that if the Board makes some changes in the next one or two months, the Legislature is going to come back and say it was a nice try but they want the Board to move a little bit more. He recalled some discussion from the Office of Management & Budget and the Commissioner's Office -- but nothing written in ink -- about $500 million, and he thought that was a step in the right direction. He appreciated the State and the Legislature working together to say that they understood that the unfunded liability is a problem. The liability was talked about as a soft liability, but he regarded it as a hard liability that needs to be taken care so the State can stay in business and people can be secure in their jobs knowing their retirement is going to be there. He said there needs to be somebody from the Legislature who can come to the table with something to offer so everyone can make progress. He agreed with Commissioner Kreitzer's earlier comment that there was good dialogue from all sides.

MR. BROOKS gave his perspective on the subject, as someone who was around when Senate Bill 125 was debated and passed in the Legislature. A key point, which Mr. Pihl has brought up, is whether there was a commitment of a 78/22 split of the $6.9 billion of unfunded liability that existed at a specific date, or if it was (coincidently) the 22% employer rate that was set that all employers would pay. The Legislature did not put a 25-year sunset on that rate. It will take another action by the Legislature to change that rate from 12.56% [for TRS] and 22% [for PERS]. The rate will either stay 22% forever, or there will be pressure to change it up or down, which is the Legislature's prerogative to do, but they are going to become an active player in the discussion at some point.

MR. TRIVETTE said the Study Group was a productive work session, the first this Board has had since it was constituted in October 2005. He suggested holding the next session as a committee of the whole because the unfunded liability is a big issue that should involve all trustees.

MR. PIHL indicated that having shepherded the Trustee Study Group through its two-day work session, he wished to step down as the chair of the group and let someone else take over. CHAIR SCHUBERT said she would take it under advisement and thanked Mr. Pihl for doing excellent work in leading the effort on what is a super-complicated issue.

UNFINISHED BUSINESS

1. **Calendar/Action Items:** No action items.

2. **Disclosure Reports**

MS. HALL stated that the disclosure memo listing financial disclosures submitted since the last meeting was included in the packet, and there was nothing unusual to report to the Board.

3. **Legal Report:** Nothing to report.

NEW BUSINESS - None.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS

JOHN ALCANTRA, government relations director for the National Education Association of Alaska, said he was present to monitor actions for almost 13,000 members of NEA Alaska. He thought that if the members could be at this meeting, they would be amazed at the skill and intellect at the table, not just of the nine Board members but of the staff at the Department of Revenue and the Department of Administration and others who serve the ARMB. NEA members would be fascinated by the big money managers and the amount of money under management and seeing the work that gets done. He mentioned that State Street Global Advisors' management fee of 2.62 basis points on over $6.5 billion in assets that they manage for the State is a fee that a defined contribution participant could never come close to getting elsewhere for money management.

MR. ALCANTRA said his initial reaction to the Board changing the earnings assumption rate to 8.0% was negative because of the impact on the unfunded liability. But he thought he would let Buck Consultants finalize it out before he got too irate, because maybe the change in the inflation assumption will make it where the unfunded liability will not grow as much as he initially worried it would when the Board passed Resolution 2010-31.

MR. ALCANTRA thanked Commissioner Kreitzer and Commissioner Galvin, who had spent a lot of time and effort working on the ARMB, and he welcomed the new commissioners Hultberg and Butcher when they arrive at the February meeting.

INVESTMENT ADVISORY COUNCIL COMMENTS - None.

TRUSTEE COMMENTS

MS. HARBO thanked Mr. Pihl for his work on the Trustee Study Group, saying she thought the group did a lot of good work in what was a very engaging meeting, and the work will continue. She thanked Commissioner Kreitzer for her work on the Board and said she would miss her.

COMMISSIONER KREITZER said it had been a delight to work with everyone, and she remarked that she was at times the more blunt of the two commissioners on the Board and she appreciated people's patience with her in that regard. She said that she and Commissioner Galvin, when they were first appointed to the Board, had talked about ensuring that the Departments of Administration and Revenue worked better together because they had heard there were some underlying issues. She was pleased with how that worked out and hoped that the other trustees recognized that the departments are working together in the best interest of the State and for those who benefit from the ARM Board's work.

MS. ERCHINGER said that as the relatively new trustee she wanted to thank Mr. Pihl for his amazing history and wealth of information on the Board, and she has learned so much from everyone, but especially from him. She said Mr. Pihl did a tremendous amount of upfront work for the two-day Trustee Study Group meeting, plus he facilitated a huge agenda and made it through all the topics. She encouraged him to continue pushing the Board on the issue because there was a lot of ground still to cover. She said what she liked most about the Study Group was the dialogue, where people felt comfortable exchanging ideas they might have strong feelings about, and where they came away learning a lot from each other.

MS. ERCHINGER thanked Commissioner Kreitzer and Commissioner Galvin and said she would miss them. She said that as an employer the experience she has had working with the two departments in her 20 years at the City of Seward has not been better than it has been under their leadership.

MR. TRIVETTE also mentioned how well the Study Group session went and that it would be easier to review all that transpired once the minutes were available. He thanked Mr. Pihl for his work as chair of the Study Group and said he looked forward to seeing the additional information that Mr. Pihl had requested.

MR. RICHARDS thanked Commissioner Kreitzer and Commissioner Galvin for their work on the Board and for the State as a whole.

MR. PIHL said, regarding the Study Group, that perhaps the Board should look at modifying its charter because he felt the Board was dealing with a problem that was outside its scope, and it was unable to meet its obligation of funding the benefits for the employees of which the trustees are the fiduciaries. He also expressed his appreciation to the departing commissioners and said he would miss them.

CHAIR SCHUBERT said it had been a delight getting to know Commissioner Kreitzer and Commissioner Galvin, and she thought their leadership to their respective staffs was important in ensuring that the two departments worked well together and things functioned as smoothly as they have. She wished them well in their next endeavors. She also thanked Mr. Pihl for taking on the difficult task of leading the Trustee Study Group and doing such an excellent job of it.

FUTURE AGENDA ITEMS - None.

ADJOURNMENT

There being no objection and no further business to come before the board, the meeting was adjourned at 4:22 p.m. on December 3, 2010, on a motion made by MS. HARBO and seconded by MR. RICHARDS.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary

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

Confidential Office Services
Karen Pearce Brown
Juneau, Alaska