State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

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

MINUTES OF
June 16-17, 2011

Thursday, June 16, 2011

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

Five ARMB trustees were present at roll call to form a quorum, and Gail Schubert joined the meeting at 9:15 a.m.

Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Commissioner Bryan Butcher
Martin Pihl
Tom Richards
Mike Williams (June 17)

Board Members Absent
Kristin Erchinger
Commissioner Becky Hultberg
Mike Williams (June 16)

Investment Advisory Council Members Present
Dr. William Jennings

George Wilson

Department of Revenue Staff Present
Jerry Burnett, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Pamela Leary, State Comptroller
Zach Hanna, State Investment Officer
Steve Sikes, State Investment Officer

Department of Administration Staff Present
Mike Barnhill, Deputy Commissioner
Jim Puckett, Division Director, Retirement & Benefits
Teresa Kesey, Chief Financial Officer, Division of Retirement & Benefits

Consultants, Invited Participants, and Others Present
Robert Johnson, ARMB legal counsel
Michael O'Leary, Callan Associates, Inc.
Paul Erlendson, Callan Associates, Inc.
David Slishinsky, Buck Consultants
Aaron Jurgaitis, Buck Consultants
Leslie Thompson, Gabriel Roeder Smith & Co.
Dana Woolfrey, Gabriel Roeder Smith & Co.
Tom Newby, Lexington Partners
Ned Notzon, T. Rowe Price
Charles Shriver, T. Rowe Price
Tony Luna, T. Rowe Price
Bob Birch, T. Rowe Price
Dr. Craig Wisen, University of Alaska Fairbanks
David Teal, Legislative Audit Division
John Alcantra, NEA Alaska

PUBLIC MEETING NOTICE

GARY BADER confirmed that proper public meeting notice requirements had been met.

APPROVAL OF AGENDA

The agenda was approved on a motion made by MS. HARBO and seconded by COMMISSIONER BUTCHER.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

Chief Investment Officer GARY BADER reported that staff responded to one communication saying that the Defined Contribution Committee would consider a request for changes in the menu of options in the defined contribution plans.

There was no one present or on the telephone who wished to address the Board.

APPROVAL OF MINUTES

<u>MS. HARBO moved to approve the minutes of the April 28-29, 2011 meeting as written</u>. <u>COMMISSIONER BUTCHER seconded</u>. The motion passed without objection.

REPORTS

1. Chair Report - None.

2. Committee Reports

2(a). Audit Committee
Committee chair MARTIN PIHL reported on the committee's June 15 meeting, at which they received a presentation from KPMG on the 2011 audit plan, a report from the Revenue and Administration Departments on efforts to facilitate the audit, and a report on compliance work. They also received a more detailed report on employer audits, including statistics on the types and frequency of reporting errors. As an example of how complicated the field of employers is to audit, staff has worked on forty-six audits this fiscal year, covering over 25,000 employees, and 15,000 of the employees are not in the retirement systems. The Committee is very pleased with the progress on employer audits. *[The minutes of the June 15, 2011 Audit Committee meeting are on file at the ARMB office.]*

3. Retirement & Benefits Division Report

3(a). Buck Consultants Invoices
Monthly invoices and a summary for the fiscal year were included in the packet.

3(b). Health Care Contract
MR. PUCKETT reported that the Commissioner of Administration had decided to unbundle the third party administrator (TPA) request for proposal (RFP) for the AlaskaCare retiree health plan and the employee health plan. He said the Division of Retirement and Benefits will have the current TPA until June 20, 2013, because one of the one-year contract extensions was exercised. During the additional one-year time frame the division will prepare to do an RFP for a wellness vendor, a third party administrator, and a pharmacy benefit manager.

This unbundling is following the industry best practices and is also a recommendation from Buck Consultants. The division believes it will allow it to provide more comprehensive and better services, which should lead to higher quality health care and results.

Responding to MR. TRIVETTE, MR. PUCKETT said the division would communicate more with members and the public as it settles on the details, that today's announcement was to give the Board a heads-up.

MR. TRIVETTE mentioned that the transition process [to new third party administrators] has been a problem historically, and he hoped that lessons learned would help the process go smoothly next time.

4. Treasury Division Report

Department of Revenue Deputy Commissioner JERRY BURNETT used a one-page chart to help answer an often-asked question of how the Alaska retirement system compares to other pension systems, given its uniqueness in funding. He said that adjusted for a number of factors for comparison purposes, such as health care funding and the five-year smoothing methodology, the Fitch rating agency would move the Public Employees' Retirement System up from a 63% funded ratio to a 81% ratio. He said staff is working with Standard & Poors on a similar type question, because their analysts look at things a little differently. Moody's rating agency is very favorable on Alaska.

MR. BURNETT stated that he planned to attend a special meeting at the Pew Center in Washington, D.C. next week on pensions and funding. He would bring any pertinent materials back for the Board.

5. Chief Investment Officer Report

Chief Investment Officer GARY BADER referred to the written report in the packet. The report included details of rebalancings and transfers that staff transacted since the last board meeting. He announced the resignation of investment officer Jie Shao and the employment of Joy Wilkinson to replace her. He is currently interviewing candidates to fill two other vacancies.

MR. BADER requested that the Board remove Relational Investors from the watch list. While Relational has had a rocky time as an ARMB investment manager, fiscal year-to-date their return is about 41%, more than enough to get them in good stead. He said the Board's patience with Relational has paid off.

<u>MR. PIHL moved that the Alaska Retirement Management Board remove Relational Investors from the Watch List</u>. <u>MS. HARBO seconded</u>.

The motion passed unanimously, 5-0, with trustees Schubert, Trivette, Harbo, Pihl and Richards present. [Trustee Butcher was out of the room.]

MR. BADER recommended that the Board place Lord Abbett's small cap mandate on the watch list. Lord Abbett's three-year return is 5.07%, while the Russell 2000 Index has returned 8.57%. Year-to-date, they are outperforming the index, but the move is still warranted. He has advised Lord Abbett of his pending recommendation to place them on the watch list.

MS. HARBO moved that the Alaska Retirement Management Board place Lord Abbett small cap on the Watch List. MR. RICHARDS seconded.

The motion passed unanimously, 5-0, with trustees Schubert, Trivette, Harbo, Pihl and Richards present. [Trustee Butcher was out of the room.]

MR. BADER informed trustees that private equity gatekeeper Abbott Capital had exceeded $1.0 billion in assets returned to the ARMB since they were hired, which is a significant milestone in the relationship.

MR. BADER reported that style preferences seem to persist longer than three years in the market, but the ARMB watch list is a three-year test. The Board discussed at its retreat looking at the watch list criteria. He distributed a chart of ARMB domestic large capitalization and small capitalization equity returns and the large cap and small cap indices. While the performance numbers were unaudited, it was interesting to see the 125-basis-point lead for the ARMB large cap composite (which includes the index funds in it) over the S&P 500 Index fiscal year to date. The portfolio has benefitted from having the buy-write index and the convertible bond index products as part of the large cap composite. The ARMB small cap composite is also leading the Russell 2000 Index slightly fiscal year to date and has done better since the beginning of the calendar year.

6. Fund Financial Report

State Comptroller PAMELA LEARY presented the retirement system financial statements for the nine-month fiscal year period ended March 31, 2011. The ending investment assets were $19.5 billion, an increase of about 20% for the fiscal year-to-date. The change due to the investment income was just shy of 18%. She also presented figures for the month of March. She indicated that all the asset allocations were well within targets.

Chief Financial Officer TERESA KESEY briefly reviewed the Division of Retirement and Benefits supplement to the Treasury report. It showed the details of the net contributions and withdrawals for the nine months ending March 31, 2011.

7. Performance Measurement - Periods Ended March 31, 2011

MICHAEL O'LEARY, Executive Vice President of Callan Associates, Inc., reported on the investment performance of the Alaska retirement systems. *[A copy of Callan's slides is on file at the ARMB office.]* He said that, with another European currency crisis and an earthquake and nuclear meltdown in Japan in the first quarter, people would not have expected equity markets to produce positive returns, but they did. Another wild card in the first quarter was a spike in many commodity prices, including cotton, oil, and copper. It was a mixed quarter for fixed income, although spreads narrowed during the quarter, so that helped returns in many fixed income categories.

MR. O'LEARY said there were signs that the growth rate in the economy was below what had been expected early in the quarter. There was concern that some of the emerging economies might be overheating and that inflation was becoming more of an issue, and that the resultant policy tightening measures could further slow growth. The concerns about the first quarter came largely after the earthquake and nuclear meltdown in Japan, and as people began to think about the effects of just-in-time inventory on supply chains and how it could affect the U.S. and European economies. That concern has extended to the June quarter, which people expect to be potentially slower than the first quarter of the year.

MR. O'LEARY stated that QE2 (Quantitative Easing Two) ends by June 30, and he did not think that most major bond managers would have expected treasury rates to be lower. During the quarter there were greater gains in credit instruments than in non-credit instruments. That has changed subsequent to the end of March as some spreads widened out slightly. He also presented a graph of emerging market yield spreads by region.

The 12-month period through March 31 was great for stock returns and okay for bonds, and the March quarter had a big preference for equities. The quarter was one of the few quarters in the last several years where emerging markets underperformed both the U.S. stock market and other developed markets.

MR. O'LEARY stated that Treasury rates cannot fall significantly from the current levels. If one believes that rates are not going lower, it takes away one of the support elements for the stock market. It is a fact that people have moved a lot of money into equity types of investments (including real estate) because they are so dissatisfied with the return that they can get from bonds. As a consequence, people who are investing the majority of their assets in equities have to think that the price they are paying for equities is reasonable. Stocks are dependent on growth to increase in value: the presumption is that over time there will be real growth, and owners in a positive growth era tend to do better than lenders. If there was no growth or profitless growth, people might be better off earning next to nothing in bonds.

DR. JENNINGS commented that other committees he is involved with have avoided making interest rate calls and repositioning the bond portfolio. Instead, the focus is more on other parts of the portfolio, having the safe assets stay safe, and possibly taking the opportunity to invest in more inflation hedges. Even if the broad sense is that interest rates in the longer term have to rise, bonds still have a role in the portfolio, by providing liquidity, diversification, and a margin of safety. He said the other committees he referenced are not shortening durations or doing any kind of strategies built around the idea that rates will eventually go up.

MR. O'LEARY said his purpose in raising the point was to say that it is important to constantly monitor the levels of valuation in all markets and to be sure that the ARMB is not getting caught up in increasing equity allocations for the wrong reason. Based on absolute valuation measures for the S&P 500 Index at the end of March (taken from the J.P. Morgan Guide to Markets Q2 2011), it does not appear overvalued — and some would say it was undervalued. Many of the valuation measures are based on projections, which raises the question of whether the projections are accurate, or if people are getting caught up in the great profit recovery experienced over the last two years and over-projecting.

MR. BADER reminded the Board that it has a policy regarding interest rates. Staff is prohibited from making big bets on interest rates because the policy states that staff will be plus or minus 20% of the duration of the appropriate benchmark. Staff follows that, and since he has been CIO he did not think they had been more than 5% away from the benchmark. They have done that for all the reasons just cited. The ARMB has also gone to a Treasury portfolio to preserve liquidity.

MR. O'LEARY said that because the retirement fund's total fixed income allocation is very small, it is critical that it provide maximum diversification given its size. Having the government bond emphasis in the fixed income category provides more diversification bang for the buck.

Deleveraging has occurred in the economy among consumers, companies, and some state and local governments — everywhere except the federal government.

MR. RICHARDS asked what would happen to stock prices when the economy begins to pick up and if interest rates rise a bit. He wondered if corporations with a buildup of cash on the balance sheets might spend it for growth.

MR. O'LEARY responded that the stock market is great in forecasting recessions that actually happen and those that do not happen, and it is also great at forecasting recoveries that happen and that do not happen. He added that generally the market today is acting largely on expectations of the cyclical short term (the next six to 12 months). If inflation is high but price increases can be passed along to the consumers, that is not necessarily bad for profits. He showed graphs to illustrate the performance of financial markets in rising inflation and falling inflation scenarios since 1971.

MR. O'LEARY stated that the real estate market had done well recently, as measured by NCREIF. However, it has a long way to go when comparing the 10-year returns for direct property (7.48%) and REITs (11.52%). He said that for the last year and a half he has reported that the ARMB's real estate performance was seriously affected by the valuation lags in illiquid investments. It was notable last year as private real estate began to have positive valuations, and now it is a wind at the retirement fund's back. The same sort of situation exists with private equity, except that private equity valuations have been a bit faster in responding than real estate.

MR. WILSON pointed out that when comparing the REIT databases to the NCREIF database the REITs typically have 30% to 40% leverage in them. Over long periods of time, if NCREIF unleveraged properties are adjusted for leverage, it would result in returns that are very close to NAREIT. So assuming comparable portfolios, the Board should not care too much whether its real estate is in NAREIT or in direct properties.

MR. O'LEARY remarked that it all depends on what the ARMB is trying to get out of real estate. MR. WILSON agreed, saying that REITs have a lot of short-term volatility.

MR. O'LEARY reviewed the actual asset allocation compared to the target asset allocation at March 31. Because equities were strong during the quarter and bonds had modest returns, the retirement fund was slightly overweight in equities. It was underweight in real assets, primarily direct real estate. Absolute return was underweight because it has not been performing as well. The overweight in private equity has been persistent since the market meltdown because of the "denominator effect." He also reviewed the ARMB asset allocation compared to Callan universe of other public funds.

Turning to performance, MR. O'LEARY stated that it was a good quarter for the fund: up 4.08% versus the target index return of 3.65%. Managers in aggregate outperformed their targets, and asset allocation relative to the targets was a slightly positive contributor. Over the trailing 12 months, the return was 13.37% versus the target index at 13.26%. He noted that private equity hurt returns for much of last year relative to public equities, but for the full 12 months ended March 31 private equity exceeded a public equity measure of return. Real assets were essentially at the target return for the one-year period. He characterized it as a marvelous 12-month period for ARMB performance.

MR. O'LEARY pointed out that the trailing five-year returns include the market meltdown, so the portfolio is still behind target. The biggest culprit is the real asset category - and specifically real estate. Compared to peers, the total retirement fund had a strong quarter, the one-year return was essentially at median, and the three-year number is still significantly affected by the timing factors in valuation because illiquid assets were not marked down quickly enough. This helped the fund in 2008, hurt in 2009 as things were marked down, and now it is shifting back to where the illiquid assets are beginning to catch up with the public assets.

MR. O'LEARY stated that Treasuries have not done as well as credit bonds during the last year. The ARMB's fixed income component is, in aggregate, significantly higher credit quality than other plans generally. The in-house bond portfolio performance should not be notably different from the Barclays Intermediate Treasury Index return, and that was borne out over the first three quarters of the fiscal year.

Mondrian has done a great job for the ARMB over the long term relative to other international bond managers. MR. O'LEARY said that Mondrian's ability to invest in emerging market debt was expanded very recently.

Lazard manages an emerging markets income fund that has done reasonably well relative to its target.

MacKay Shields is now the ARMB's only high yield bond manager, and they have underperformed the high yield target over most of the last five years. MR. O'LEARY said he is happy that the ARMB has high yield exposure because high yield bonds have produced a greater return than the aggregate index, even through the market meltdown. However, the relative underperformance of MacKay Shields is getting to the point of being troublesome. Part of the high yield market that has done exceedingly well in the recovery has been the lowest credit quality junk bonds, and he could understand and accept that MacKay Shields is underperforming a broad index of the high yield market. But they need to find an environment in which they are going to do better than average, because the Board is paying them an active management fee.

MR. O'LEARY reported that the total domestic equity pool did better than the total broad domestic equity market over the trailing 12 months ended March 31. The large cap domestic equity pool was slightly behind the Russell 1000 Index for the last year, and fiscal year to date it is above the index. Over the three-year period, the large cap equity pool outperformed. There is no pronounced style bias in the large cap pool, but a narrow market where mega-cap, high-quality companies outperformed everything else would probably be the environment in which the large cap pool would do less well than the measures of the market.

The domestic small cap equity pool in aggregate was a positive contributor to total performance, even though it underperformed its target, because its returns were better than the large cap pool. MR. O'LEARY mentioned that at the last meeting the Board approved shifting some money from small cap indexing to an active manager, in order to reduce the over-reliance on the small cap value index. The Board also approved a manager search for another small cap equity manager and placed Lord Abbett on the watch list. Lord Abbett is the reason that the small cap pool underperformed its target in both the fiscal year to date and the trailing 12 months, while the other active managers outperformed.

The long-term record of the ARMB international equity portfolio is very good relative to other public funds. The one-year return was above the benchmark, but the nine months of the fiscal year to date lagged the peer group. The international developed markets managers outperformed the developed markets index for the trailing 12 months. Capital Guardian was the best performing large cap manager for the year. The weak performers for the one-year period were Brandes and the international piece of Lazard's global portfolio.

MR. O'LEARY said all three managers in the emerging markets pool (Capital Guardian, Eaton Vance & Lazard) underperformed the emerging markets benchmark for the year, with Lazard being the weakest. There is a value tilt to the emerging markets pool. The Eaton Vance product has frontier markets exposure, which tends to be more volatile than emerging markets, and it has meaningful exposure to the Middle East.

Lazard's global portfolio had weak performance for the year, but their returns over three years have been very strong. Their performance relative to their target over a very long period has been very competitive. MR. O'LEARY said he was not troubled by Lazard's underperformance for the one-year period, and with their long-term record comfortably above the benchmark there is no reason to watch list them.

MR. O'LEARY mentioned that the total energy funds that are part of the real assets category have made a nice contribution to the overall portfolio for a long time. He noted that ARMB is one of the few funds that has had money invested in farmland for a meaningful period of time, and he wished it were possible to have a larger allocation. Unfortunately, both UBS Agrivest and Hancock Agricultural have queues to get money invested in farmland. Regarding REITs, he looked forward to the internally managed portfolio being off the watch list at a future meeting, as time passes and the three-year return number loses some of the bad quarters. Lastly, the internally managed TIPS portfolio return was right on top of the index for the 12 months ended March 31.

MR. O'LEARY reported that over the last two years the absolute return composite has done better than the target but well below the absolute return hedge fund of funds median. Although 4.9% for the last 12 months is not an impressive number for the composite, it was essentially at median. Crestline has been an absolute return manager for the ARMB the longest and has done the best of the managers. GAM and PRISMA are very new managers for the ARMB, so their record is not meaningful. Mariner has a meaningful record for the ARMB and has a fixed income orientation; they were added to the watch list in December for organization issues and performance.

MR. O'LEARY referred to a two-page summary that listed investment managers with strong relative performance, as well as managers with disappointing performance, over one year and longer-term periods (slides 44-45). He said that a consistent feature of the stock market recovery has been companies reporting earnings higher than analysts were predicting. He thought companies were at a transition point in profit growth and that there would be a greater incidence of earnings disappointment. Some of that will be due to legitimate impacts from the supply consequences associated with the Japanese earthquake and tsunami tragedy in March, and some of it will be because analysts were getting too bullish about the outlook. In that kind of environment there is more rotation within the market. By reasonable measures, stocks do not appear to be overvalued. However, people do have to educate themselves that a 4% or 5% return from investment-grade bonds would be marvelous if they could get it.

MR. O'LEARY stated that Callan conducts a lot of manager searches in a year and they have many public fund clients. They see people going in all sorts of different directions. A reasonably common takeaway is that people seem to be embracing real assets, which they have not done up until now. Callan sees fear manifesting itself in people investing in blended products at firms, such as Capital Guardian and PIMCO, that can use their multiple capabilities to time when to emphasize emerging market debt over emerging market equity or vice versa. Callan sees the same sort of case in the real assets area; Wellington has a product called Diversified Inflation Hedges, where they buy energy stocks, REITs, commodities, and TIPS. It remains to be seen whether any of these managers will be successful. Lastly, a tremendous amount of money is being allocated to hedge funds.

Noting that T. Rowe Price would be making a presentation later, MR. O'LEARY said he was pleased with how the individually managed account programs the firm manages were performing.

MR. BADER asked Mr. O'Leary if his comment about people migrating to hedge funds included the absolute return product the ARMB invests in.

MR. O'LEARY said absolute return was a subset of the hedge fund universe. When Crestline made a presentation to the Board in April they mentioned that in order to fit into the absolute return subset they have to be very conservative, and if they had a bit more flexibility they could do better. He said he did not dispute that in Crestline's case.

MR. BADER remarked that staff would be talking about hedge funds and absolute return later in the meeting, and he wanted to make the point that absolute return was a limited subset.

CHAIR SCHUBERT thanked Mr. O'Leary and called a scheduled break from 10:55 a.m. to 11:10 a.m.

8. Lexington Partners - Private Equity

TOM NEWBY gave a report on the Lexington Capital Partners VII Fund in which the ARMB is invested. *[A copy of the slides for this presentation is on file at the ARMB office.]* He started with an overview of the firm, its focus on secondary private equity transactions, and its presence around the world. At Mr. O'Leary's request, he also spent a few minutes explaining why a limited partner would want to sell an interest in a private equity investment. He said they have never put any leverage at the fund level, and they have generated a net IRR of over 20% for the limited partners since inception.

MR. NEWBY reviewed information about the secondary market in general, including the growth in secondary transaction volume over the last 20 years. He said the weighted average age of the private equity partnerships that Lexington is acquiring today is 5.5 years, meaning 2004-2005 vintage funds. These are typically mature funds that are through the investment period, so Lexington has good visibility into the assets and can see how those investments are performing and the future potential.

MR. JOHNSON and MR. NEWBY briefly discussed accounting for unfunded commitments or limited partner clawbacks.

MR. NEWBY explained that the turnover rate is increasing every year, so it is becoming more accepted for limited partners to be selling into the secondary market. He said Lexington is largely buying from the 2005-2009 vintage year group for Lexington Partners Fund VII, a period when a total of $1.6 trillion was raised by private equity groups. They are also buying in the 2000-2004 time frame.

MR. NEWBY talked about the purchase price discounts to net asset value over different time periods, and highlighted the peak in discounts in 2002 and 2009. He said things are not as bad from a seller's perspective today as they were in 2009, and they are seeing discounts in the 15%-30% range, which is essentially within historical ranges. There are a number of transactions getting done today at fairly thin discounts; those are typically smaller transactions but in mega buyouts. They have been very surprised at how well mega buyout funds have fared throughout the slow economic recovery.

MR. NEWBY reviewed Lexington Capital Partners VII (LCP VII) that is focused globally on mature secondary interests. The final close of the fund will be June 30, with an expected capitalization of $6.0 billion. They have committed to 16 secondary transactions, including three of the largest 10 secondary purchases in 2010. About half are domestic assets and about 70% are buyout interests. They have committed to invest about $2.0 billion, and they have been able to acquire those interests at a 28% discount to market value. Rapid distribution activity is a benefit of a secondary fund, and about $220 million from Fund VII will be distributed to the limited partners in July. The deal pipeline is quite strong for deploying the fund, and Lexington is currently working on $14 billion worth of transactions. The sellers are a mix of financial services, pension funds, endowments, sovereign wealth funds, and family offices.

MR. NEWBY stated that the ILPA scorecard for LCP VII is important to Lexington, that they are limited partners as well as a general partners, and alignment of interest matters a lot to them.

MR. NEWBY answered a couple of questions before CHAIR SCHUBERT thanked him for the presentation and recessed the meeting for lunch at 11:48 a.m.

The meeting reconvened at 1:02 p.m.

9. T. Rowe Price - Portfolio Review

MR. BADER provided some background on the State's nearly 20-year relationship with T. Rowe Price. He said Ned Notzon, who was there at the beginning in 1991, was retiring, and he would miss him a lot. The relationship has been very positive and he has always liked Mr. Notzon's candor. The firm manages over $2.0 billion for the Alaska retirement funds.

NED NOTZON, CHARLES SHRIVER, TONY LUNA, and ROBERT BIRCH of T. Rowe Price made a multiple-part presentation on the suite of investment options they manage for the ARMB in the defined contribution plans. *[A copy of the slides used in the presentation is on file at the ARMB office.]*

MR. BIRCH stated that, upon Mr. Notzon's retirement on October 1, Charles Shriver would become co-manager of the relationships for the State of Alaska, along with Rich Whitney. He gave a brief update on the firm and noted that there had been no changes to any of the portfolio management assignments for the underlying building block portfolios since they last met with the Board.

MR. NOTZON talked about the popularity of preconstructed portfolios and said the most successful one in many ways was the Alaska Balanced Fund that started in 1991. That fund has a 35% allocation to stocks and has earned 7.5% annually; if the stock allocation had been greater than that the fund would not have done as well. He noted that Alaska's is the most conscientious group he works with, in terms of people trying to understand what is happening and expressing their value systems through the investments that are chosen. He said he hired Mr. Shriver 12 years ago, and he became the number two person on all the portfolios. Last year he turned $5.0 billion in assets over to Mr. Shriver to manage as the lead manager, and he has done very well with all of them. During the remainder of the year he will turn over management of the remaining $23.0 billion to Mr. Shriver.

MR. NOTZON reviewed the asset allocation team. He stressed that T. Rowe Price has a long-term reputation for being very down-side sensitive; they are conservative and do not want bad things to happen. They have found that being second quartile forever is a very good place to be and oftentimes eventually gets them to first quartile. T. Rowe Price missed the tech bubble by underweighting stocks for two years before the bubble burst and shifting stocks primarily to the value area. They missed the subordinated debt crisis with mortgages because their research analysts figured out that it was not a sustainable market. They sleep well at night because they err on the side of caution, and that is very compatible with the Board's investment values and philosophy.

MR. SHRIVER gave an overview of the investment options, both the separate accounts — including the array of target date trusts, and the common trust funds at the building block level. He noted that the Alaska Target 2010 Fund will end June 30, 2011, and distributions will go into the State Street Institutional Money Market Fund. He described the glide path for the Alaska target date trusts that range from 2010 to 2055. The asset allocation between stocks and bonds starts at 90% equities when investors begin working and automatically gets more conservative over time until it reaches 55% equities at retirement and continues to get more conservative through retirement until it has a 20% allocation to equities 30 years into retirement. The point is to distribute risk along the lifetime of the investor such that they take a greater risk when they can most afford it, as they continue to contribute to the plan.

MR. NOTZON described the development of the investment options over 19 years. He said the decisions that improved the retirement plans included the State allowing participants to leave their money in the plan after retirement; turning the funds into trusts; and providing the same basic offerings in the Supplemental Benefit System (SBS), PERS and TRS, so people have a consistent framework.

MR. SHRIVER reviewed the attributes of the Alaska retirement plans, which were custom designed through working with the Board and staff over time to meet Alaska's investment and risk objectives.

MR. O'LEARY mentioned that 20% of the equity percentage of a particular target date fund being in non-U.S. equity is perceived as comparatively low. He said the international equity allocations in typical multi-asset category funds have increased. He asked about the probability of the international equity allocation being changed upward again in the T. Rowe Price target date funds over the next couple of years.

MR. SHRIVER replied that international equity moved to a neutral allocation of 20% of total equity in 2009 based on the increasing global economic contribution to corporate earnings and GDP. It would be reasonable to continue to increase that allocation, and they have adopted that profile within other T. Rowe Price portfolios to increase international equity to 20% and ultimately to 30%. He clarified that the international equity allocation in the Alaska plan is a developed markets portfolio and does not include emerging markets.

MR. NOTZON stated that two changes T. Rowe Price intended to start discussions with Mr. Bader and his staff about are the 20% versus 30% exposure to international equity and adding some emerging market equity exposure. He remarked that it is not as cheap to buy emerging market stocks; however, it would be a tiny percentage of the whole portfolio.

MR. SHRIVER reviewed the current asset allocation to stocks, bonds and cash in the target date and balanced portfolios. He also reviewed the sector diversification in the stock trust, the bond trust, and the money market trust.

MR. SHRIVER stated that T. Rowe Price has the ability to overweight and underweight stocks versus bonds, or U.S. versus non-U.S. equities, in the Balanced Trust and Long-Term Balanced Trust. Currently, they are overweighting equities within the portfolio, which is consistent with the view of the T. Rowe Price's asset allocation committee of senior investment managers that meets on a monthly basis to look at relative valuations across the global marketplace, generally taking a six to 18-month view. Some of the rational for overweighting stocks is based upon an economic outlook of moderate growth that is characterized by a gradually improving economy that is coming along at an uneven pace. Their chief economist sees stronger growth in the second half the year, as some of the headwinds seen in the first half begin to abate (high energy prices, and the slow-down in manufacturing influenced by disruption of the supply chain from Japan). The 2011 GDP expectations are about 2.8%. Jobs are critical to the picture. Unemployment has bumped back over 9%, following steady improvement in the February to April period. Based on the chief economist's projections, T. Rowe Price expects the unemployment rate to gradually work down to 8.6% by the end of the year. Corporate profits have been strong in the recovery, and margins have been historically high as corporations cut back on capital expenditures and employees over the course of the recession. As productivity begins to abate, it is likely that corporations will invest some of that money first into extending the work week and ultimately into hiring and increasing capital expenditures, getting close to replacement rates.

MR. SHRIVER said T. Rowe Price believes equity valuations are reasonable relative to history, so they are overweight equities at this point. While it was not part of their decision, they looked at what rates will do. Rates may remain lower for longer in the current economic environment, but the likely trend over time is going to be modest upward pressure, in particular because of the significant supply of treasuries that will come due given the debt situation, and with the abatement of the Federal Reserve's quantitative easing program at the end of June. These are factors that would put upward pressure on rates — both from the supply side and from demand — over an intermediate term period.

MR. SHRIVER presented performance numbers that were net of fees and expenses:

- Alaska Balanced Trust, 9.41% for one year ended March 31, 2011.
- Alaska Long-Term Balanced Trust, 12.15% for one year.
- Target Retirement 2010 Trust through 2025 Trust have higher equity allocations so they had more significant absolute returns over the year but slightly underperformed the custom index in the one-year period. The three-year and five-year records have been strong relative to the weighted benchmark.
- The longer-dated Retirement Trusts 2030 to 2055 all have a fairly common equity allocation. They had similar performance in the 14%-15% total return range and underperformed the weighted benchmark over the one-year period.
- The Aggregate Bond Trust, 5.17%, modestly outperformed the benchmark for the year.
- The U.S. Equity Market Trust, 17.29%, modestly underperformed the benchmark.
- The International Trust, 10.75% for the year, also underperformed the benchmark slightly.

MR. SHRIVER remarked that it has been a very strong rally off the stock market lows, so it is not unexpected that the market would take a pause. He went into detail on the return attribution, using the Alaska Balanced Trust as a proxy for all the funds.

MR. LUNA spoke on the two stable value separate accounts he manages: the Deferred Compensation Plan Interest Income Fund, and the Supplemental Annuity Plan Stable Value Fund. He said that coming out of the financial crisis the stable value industry is going through an evolution. The performance of the two accounts was very strong over the one-year period and longer.

Stable value is typically a substitute for a money market option. The three primary objectives are principal preservation, to provide a premium over a traditional money market fund, and to be more stable than a traditional money market fund. MR. LUNA explained how stable value is constructed of cash reserves and synthetic investment contracts (derivatives). For a wrap fee, a counterparty wraps a bond portfolio to absorb the volatility of the underlying bond portfolio, and they provide a zero percent floor for participants to preserve principal. Lastly, a contingent insurance is that participants always have a book value guarantee if the market value of the bonds is less than par.

Responding to MR. O'LEARY, MR. LUNA said that if a plan sponsor makes changes to the plan that impact participant behavior and significantly impact the cash flows of a stable value fund, etc., there would still be some insurance but it would not be as black and white.

MR. O'LEARY mentioned that in an environment where the yield differential is as great as it appears to be between money markets and stable value funds, a lot of money would come into the stable value fund that would be invested in today's interest rate environment. That would dilute the return available to people who had already put their balances in there. He said those dynamics are very important.

MR. LUNA agreed that the yield from stable value is impacted by new cash flows coming in.

MR. WILSON commented that the insurance company aspect is very important. MR. LUNA explained how synthetic investment contracts mitigate the risk of having direct counterparty exposure because the plan owns the underlying collateral, unlike the guaranteed investment contract products of the early 1990s. He added that currently the market-to-book is at about 105 or 106 for their stable value funds, so the actual economic exposure to the counterparties is zero. If everything went under, and T. Rowe Price had to liquidate the assets, the participants would actually realize an instantaneous 5% or 6% gain to their portfolios. MR. WILSON said stable value will work very well when market conditions are stable, but people get nervous when market conditions get like 2008 when a lot of pieces are under water.

Referencing Mr. O'Leary's question about interest rates being dragged down, MR. LUNA explained the equity wash provision at the plan level that is designed to protect the long-term stable value investors, as well as the wrap providers. The provision prevents participants from transferring directly from stable value to money markets in order to arbitrage rates; instead, participants must first take some kind of market risk for 90 days.

MR. LUNA reported that there is a lack of wrap capacity and a consolidation among stable value managers. Many stable value funds are currently yielding 1.0% and have market-to-book ratios that are under par. These funds have wrap providers that are exiting the partnerships, and some firms have closed their funds in the last six months.

MR. O'LEARY asked for comment on regulatory uncertainty that directly affects stable value. MR. LUNA said the Dodd-Frank Wall Street Reform and Consumer Protection Act basically gave the CFTC (Commodity Futures Trading Commission) and the SEC (Securities & Exchange Commission) the mandate to evaluate derivative contracts and systematic risk, and stable value funds got swept into that. The CFTC and the SEC have quickly identified that stable value wrap contracts do not represent systematic risk. It seems that they are not going to necessarily issue an opinion in the 18-month timeframe they were given, and T. Rowe Price will wait to see the official outcome. The CFTC and the SEC have the authority to change how stable value contracts are defined, without going back through the legislative process.

MR. BADER requested comment on the index the underlying bond funds are managed to and its relevance to the volatility of a stable value fund. MR. LUNA said the current strategy is the Barclays Intermediate Aggregate Index that has a duration of about 3-1/2 years historically. Over time, the return of the Intermediate Aggregate Index will get passed on to the participants, net the wrap fee. The wrap fee absorbs the volatility of the index over time and provides a zero percent floor.

In response to Mr. O'Leary, MR. LUNA stated that stable value funds used to be considered a safe harbor option under ERISA, but on reconsideration the Department of Labor determined that stable value would not satisfy the requirements for a qualified default option. He thought it was bad timing because it happened right before the market turmoil of 2008.

MR. LUNA said he hears the question of whether stable value is appropriate going forward, given the level of interest rates. The difference between stable value and money market yields is at historic wides of 300-400 basis points. T. Rowe Price does not have an instantaneous 300 or 400-basis point interest rate rise built into their forecasts as a base case. They believe that stable value will provide some kind of premium over money market funds and is a very good investment option.

MR. LUNA stated that bad investment management in stable value has a lot of people working through the problems. He noted that in 2007 the performance of Alaska's two stable value funds was a bit below median. But the Hueler Index returns were bunched very close together, and the difference between median and below median was probably only 10 basis points of yield. At that time, many of T. Rowe Price's competitors were reaching for yield in AAA-rated subprime assets, so they were getting more yield, and T. Rowe Price's relative performance suffered for it. The impact of the subprime debacle became very recognizable in 2009, and the ramifications are still being felt today. The yields on Alaska's two stable value funds have remained very stable and static in a very volatile market, and T. Rowe Price is proud to have delivered a safe harbor option that delivered competitive returns when participants needed them the most, which was in 2008-2009. Both stable value funds are currently in the top quartile.

MR. LUNA explained that wrap providers were caught off guard by some of the underlying investment management of the assets in the industry. Now, those providers are moving away from certain relationships and reducing their capacity. To date, T. Rowe Price has not had any problems with its stable value portfolios. They feel fortunate that their credit analysts did a good job of steering them away from companies like AIG, which has left the business.

MR. LUNA outlined the issues facing stable value funds. There is little wrap capacity, so not a lot of counterparties to do business with. However, T. Rowe Price has been approached by banks that do have capacity that has been freed up by other funds closing. Wrap providers are de-risking their book of business because of what happened in 2008 — revising their guidelines and becoming more restrictive. That does not impact T. Rowe Price because they have already been running the portfolios appropriately for stable value. Thirdly, the provisions of wrap contracts are changing — nothing significant that T. Rowe Price has not been able to negotiate away. Lastly, wrap fees are going up. Three years ago the average wrap fee was around eight basis points, and the weighted average now in the Alaska separate account is about 15 basis points. The market is currently pricing wraps at 20 basis points.

MR. LUNA said that all those things together will probably erode stable value premiums over money markets over time. Eventually the more conservative guidelines will be coming T. Rowe Price's way, which could mean a shorter duration in the portfolios. They will keep staff apprised of any changes. Their biggest concern going forward is the headline risk that a manager is going out of business and how that impacts the industry. In his 15 years of working in stable value, he has never seen the industry level issues drive what is happening at the portfolio and security level like now with the new guidelines. He expects that looking back three years from now people will see that it was an evolutionary change in the way stable value is managed.

MR. BIRCH reviewed the Small Cap Stock Trust that is a very broadly diversified portfolio of roughly 300 small growth and value stocks. By investing in both growth and value stocks, the portfolio provides exposure to a wide swath of the small cap market without exposing participants to the sometimes extreme volatility that one might get in either of those areas. The majority of the portfolio is invested in companies with market capitalizations of $2.0 billion and less. The goal is to add value relative to the Russell 2000 Index and with less volatility than the benchmark.

MR. BIRCH stated that there have been no changes to the small cap investment team.

He also talked briefly about the investment process. T. Rowe Price struggled a bit with performance in 2008 during a period when the market was very narrow and more speculative names were leading the way, specifically some of the commodity and energy names. The subsequent period was an environment in which T. Rowe Price was able to position the portfolio in a number of very attractively priced securities, which continue to benefit the portfolio's performance. Over the one-year period ended March 31, 2011, the portfolio returned 32.1%, net of fees, which was approximately 630 basis points in excess of the benchmark return.

MR. BIRCH explained a graph of rolling three-year returns for the Small Cap Stock Trust. He said that environments where the market returns were greater (usually more aggressive markets) tended to be the environments where the portfolio did not do quite as well. Conversely, those periods where the market returns were a little sloppier were the times when the Small Cap Stock Trust tended to outperform. The returns tend not to differ by extraordinary margins from the benchmark, as this is intended to be a more conservative offering within the small cap arena. He said the Board was concerned about the relative performance of the small cap product in 2008, and T. Rowe Price appreciated the Board's patience and hoped the participants felt similarly.

MR. TRIVETTE asked what issues T. Rowe Price thought the ARMB should be looking at over the next two to three years. MR. SHRIVER replied that, working with the Board, they built a good lineup of investment options. He anticipated a continuing dialogue on fine-tuning the sector exposures; a starting point would be international and emerging markets, as mentioned earlier, and that the discussion would identify other elements that make sense.

CHAIR SCHUBERT thanked Mr. Notzon for his service to the Board and to Alaska and wished him well.

There was a scheduled break from 2:45 p.m. to 3:00 p.m.

10. Actuarial Review

MR. BADER referenced an April 19, 2011 memorandum signed by Commissioner Becky Hultberg approving changes to assumptions for the Judicial Retirement System effective with the June 30, 2010 actuarial valuation report. *[on file at the ARMB office]*.

10(a). Judicial Retirement System
National Guard Naval Militia Retirement System
Certification of Actuarial Valuation Review - FY10

LESLIE THOMPSON of Gabriel Roeder Smith & Company (GRS), the ARMB's auditing actuary, introduced her colleague, DANA WOOLFREY, a consultant who works closely with her on Alaska's account.

[A copy of the GRS audit report is on file at the ARMB office.]
MS. THOMPSON reported that the only finding for the National Guard Naval Militia Retirement System (NGNMRS) was very minor and had to do with the age for the deferral of the disability benefit. Buck agreed that disability benefits commence immediately, and they will fix that for the next valuation.

MS. THOMPSON pointed out that the chart of Buck's liabilities by benefit type against what GRS determines using their parallel procedure showed matching almost to the dollar for NGNMRS.

MS. THOMPSON next presented the GRS test case results for the Judicial Retirement System (JRS). It was a very close match on the pension side and a broader but still very good match on the retiree medical side. There was nothing to cause any concern, and GRS considered it a very clean audit on both plans. GRS spent more time than they normally do on this audit to ensure that the changes in assumptions were truly implemented and included in the calculations.

MR. PIHL had a brief exchange with MS. THOMPSON about the $300,000 per year cost of pension and health benefits for the test case judge based on 5.6 years of service.

MS. HARBO pointed out that the report conclusion indicated the JRS system was closed, but it is not a closed system. MS. THOMPSON indicated she would fix that wording.

MS. HARBO asked if it was significant that COLA (cost-of- living adjustment) was not included in the Buck valuation report. MS. THOMPSON said GRS was simply recommending that Buck add that disclosure to the report.

10(b). Actuarial Valuation - FY10
Judicial Retirement System and
National Guard Naval Militia Retirement System
DAVID SLISHINSKY and AARON JURGAITIS of Buck Consultants presented the results of the 2010 actuarial valuations for the Judicial Retirement System (JRS) and the National Guard Naval Militia Retirement System (NGNMRS). The actuarial valuation is prepared every other year in the even years for these two systems. In the odd years, Buck does a roll-forward valuation. *[A copy of Buck's report is on file at the ARMB office.]*

MR. SLISHINSKY said there were no changes in the benefit provisions for JRS and NGNMRS, nor any changes in the valuation methodology. However, there were significant changes in the actuarial assumptions that came out of the experience analysis that Buck performed last year, which were incorporated into the valuations for fiscal year 2010. The health care base claim cost rate methodology for JRS was unchanged except for the lag for medical claims that was also applied to the Public Employees' and Teachers Retirement Systems in April.

MR. PIHL noted that the investment return assumption for JRS was also changed to 8.0% from 8.25%.

MR. JURGAITIS explained that the health care base claim cost rate for PERS, TRS and JRS is calculated by aggregating all the claims together. In future valuation reports Buck will start accounting for the Cadillac tax, a piece of the health care reform legislation that was developed to help fund provisions of the health care reform. In 2018 a tax will be levied on the high cost plans to raise money and to dissuade plans from offering their retirees overly rich health plans. When determining the impact of the Cadillac tax, the legislation allows the plans to blend the pre-Medicare retirees and the Medicare retirees together. The annual claims cost for the pre-Medicare retirees is significantly higher than for the Medicare retirees. Blending the two groups together results in a much lower average cost. Under the Cadillac tax, the threshold is being set at $10,200 per person or $27,500 per family. Any costs above that will be taxed at 40%, and the tax is borne solely by the employer or the plan sponsor. Blending will push the effective date out quite a bit; otherwise the tax would apply to Alaska's pre-Medicare retirees around 2018. Future valuation reports will include an estimate of what the cost will be, the impact on the liability, and when Buck estimates the Cadillac tax will start taking effect for Alaska's plans.

MR. SLISHINSKY reviewed the member data for the Judicial System, followed by an explanation of how Buck developed the actuarial value of assets. He also described the determination of the employer contribution amounts. The calculations included the changes in the assumptions, so the value of the accrued liability that was $148.7 million in 2008 increased to $184 million in 2010 due to accrual of benefits and the change in assumptions. Subtracting the actuarial value of assets of $134 million left an unfunded liability of a bit more than $50 million for JRS. That compares to $7.5 million in 2008. The funded ratio dropped from 95% in 2008 to about 73% in 2010.

MR. SLISHINSKY said the 2010 employer contribution for JRS is $8.4 million, or 69.48% of pay. It is a large change from 2008: the roll forward calculation last year was 47.5% of pay, and that included asset losses from 2008 to 2009. The changes in assumptions included a change in mortality that increased the employer rate a bit less than 5% of pay; retirement rates were change that resulted in almost 6% of pay; salary scale added another 2% to the employer rate; and the change in the interest rate from 8.25% to 8.0% increased the employer rate about another 3.3%. All those assumption changes increased the employer contribution rate a little over 16% of pay.

MR. BARNHILL asked what the normal cost contribution rate was. MR. SLISHINSKY said the total was 38% of pay. He added that, with a turnover of 12 in the active judges group, the average entry age increased from 45 to 47. The higher the entry age of the group, the higher the normal cost rate is for the benefits because there is a shorter period of time to fund those benefits. That increased the normal cost rate almost 4% of pay. The actuarial assumptions applied in the valuation this year increased that normal cost rate of 38% an additional 7% of pay, up to 45% of pay. That does not include the member contributions.

MR. SLISHINSKY reviewed the history of the JRS total employer contribution rate, the history of the actuarial accrued liability split between pension and health care, and the funding ratio fluctuations over the years.

MR. TRIVETTE said he did not realize that any of the assumptions the Board made were going to result in a 16% increase in the liability. He thought it was imperative for a committee to do some work on some of the key things Buck was talking about that were not in the slide presentation but that might be embedded in the body of the report.

MR. SLISHINSKY referred Mr. Trivette to the September 2010 Buck presentation to the Board, where they presented the experience analysis results. He said page 76 of that report showed the breakdown of the changes in the employer contribution rate due to the demographic changes. Buck had also showed a scenario #3 that showed the impact of decreasing the discount rate from 8.25% down to 8.0%.

MS. HARBO recalled that the State made a lump sum contribution to the Judicial System in 2007. MR. SLISHINSKY said the State's payment was to pay off the unfunded liability. He added that a lot of the issue of making a large payment into the pension fund is timing. In this case, it was right before poor investment returns. It actually created more unfunded liability by paying it off than it would have if the State had waited and paid over time.

MR. SLISHINSKY reviewed the member data for the military system compared to the last valuation done in 2008 and the roll forward in 2009. He also explained the development of the actuarial value of assets, and the actuarial contribution calculation. The actuarial value of assets exceeded the accrued liability by close to $2 million, so the funded ratio was 106.5%. Normal cost was $605,000. The total required actuarial contribution was $431,000. There have been contributions to the system in excess of what was actuarially calculated.

The valuation interest rate used for NGNMRS in 2008 was 7.25%, and that was reduced to 7.0% in 2010, consistent with the other economic changes that were made to the other plans. In addition, the mortality table was changed, which actually increased the employer contribution by about $7,000. Termination rates were increased, which reduced the contribution by $193,000. Retirement rates were changed, which reduced the contribution by $164,000. And some disability changes decreased it by about $11,000. In total, the demographic changes decreased the contribution by $361,000.

MR. SLISHINSKY reviewed the history of the NGNMRS total contribution amounts and the funding ratio history.

He then walked through what contributed to the increase in the unfunded liability for JRS from 2009 to 2010, as well as the sources of the drop in the unfunded liability for NGNMRS that resulted in a plan surplus for the same period.

MR. SLISHINSKY referred to a one-page summary of all the employer contribution rates and amounts for FY13, as well as the State assistance amounts for PERS and TRS (slide 21). He said Buck was asked to calculate the level dollar amount amortization rates - what the contribution rates would be if they had used a level dollar amount for PERS and TRS in amortizing the unfunded liability, instead of the level percentage of pay approach. The level dollar amortization amount on PERS was 40.15% and on TRS was 62.26%. The amount of the State's level dollar contribution on PERS would be $469.8 million (versus $307.3 million under level percentage of pay). For TRS, the State's assistance amount under level dollar amortization would be $398.6 million (versus $302.8 million under level percentage of pay). The total State assistance for PERS and TRS would be $868.4 million, an increase of 42% over the $610.1 million — a significant difference by changing the amortization to a level dollar amount.

10(c). Board Discussion/Questions

MR. PIHL sought confirmation from Buck that if the Board stayed with the level percentage of pay approach — meaning a PERS employer rate of 32.83% for FY13 and a 49.56% rate for TRS — that the unfunded liability would continue to increase. MR. SLISHINSKY said yes. He added that there are still losses that are delayed for recognition of the actuarial value of assets. So, to the extent that those losses over the next four years are incorporated in the actuarial value, there will be losses on the assets side, unless there are significant investment returns in that period to offset those losses.

MR. TRIVETTE said he thought the Trustee Study Group addressing unfunded liability issues had requested additional information on where the retirement systems would be today if the Board had been using level dollar amount amortization rates since 2006 [when the change was made to the level percentage of pay method]. He wondered how that would affect the plans long term if the Board made that change now.

MR. SLISHINSKY said Buck had not been asked to do those calculations, but they would be happy to present those results at the September meeting, if the Board wanted them.

MR. PIHL bemoaned the impact on the unfunded liability of changing the amortization methodology to percentage of payroll on both defined benefit and defined contribution. He said the approach takes credit for dollars that are not coming into the system until way late in the game of trying to retire the unfunded liability. He felt that the liability would continue to grow for five more years if the process continued on the current path, until the defined contribution payroll and the defined benefit payroll become more even.

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

The motion carried 5-0, with trustees Trivette, Harbo, Pihl, Richards and Schubert voting.

MR. TRIVETTE moved that the Alaska Retirement Management Board accept the actuarial valuation reports prepared by Buck Consultants for the Public Employees' Defined Benefit, Teachers' Defined Benefit, Public Employees' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits), and Teachers' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits) retirement systems as of June 30, 2010, in order to set the actuarially determined contribution rates attributable to employers. MS. HARBO seconded.

MR. BARNHILL made it clear that the recommendation only put before the Board the actuarial valuation reports that were presented at the last meeting and not the JRS and NGNMRS valuation reports. He added that under statute the commissioner of the Department of Administration is charged with adopting assumptions and rates for the Judicial Retirement System.

The motion passed unanimously, 5-0, with trustees Trivette, Harbo, Pihl, Richards and Schubert present.

RECESS FOR THE DAY

CHAIR SCHUBERT recessed the meeting at 4:16 p.m.

Friday, June 17, 2011

CALL BACK TO ORDER

The meeting convened for the second day at 9:03 a.m. Trustees Schubert, Trivette, Harbo, Richards, and Williams were present. Commissioner Butcher arrived mid-morning.

REPORTS (Continued)

11. IFS Report - Action Items

MR. BADER said that Independent Fiduciary Services (IFS) had conducted an independent review of the Board's investment policies and the performance consultant and had presented its final report at the December 2010 board meeting, including a list of recommendations. At each meeting staff had presented responses to the IFS recommendations related to board policies, and had covered 16 so far. He was continuing that systematic review now by reviewing recommendations relative to absolute return:

IFS Task Area B.4, Recommendation #1
IFS Task Area B.4, Recommendation #2
IFS Task Area B.4, Recommendation #3
Correlation/Beta Change

State Investment Officer ZACHARY HANNA, who manages absolute return investments for the ARMB, reviewed the IFS recommendations and staff's suggested responses for the Board to act upon. He reviewed the action memorandum from staff, along with the redline version of the Absolute Return Investment Policies and Procedures *[both included in the meeting packet]*. The Policies and Procedures were revised to:

- More explicitly allow for strategy specific guidelines to be tailored (by contract or written ARMB staff direction) to particular investment mandates and styles.
- Provide more granular strategy exposures using the Dow Jones Credit Suisse Hedge Fund Index categories.
- More permissively allow for risk hedging at the portfolio level with staff approval.
- Change the ARMB's diversification measurement from a correlation maximum, which takes into account the direction of returns, to a beta target, which better takes into account the direction and the magnitude of the relationship between the absolute return of returns and various market indices. It is a target that managers can manage to more easily.

MR. O'LEARY remarked that a 0.25 beta maximum seemed like a low beta target, and he wondered if the change begat much discussion with the managers. MR. HANNA replied that managers did not have a lot of heartache with it, for the most part. It is the softest of the guidelines; it is a target and not an absolute mandate, and it is over a three-year rolling period. The portfolios are very absolute return oriented and not very directional; most of the managers target a beta of 0.15 or 0.2, so actually lower than the proposed target, and they do not anticipate this becoming an issue. Staff is looking at adding some additional long/short equity exposure to the Crestline portfolio, and that might cause them to be on the higher end.

MR. WILLIAMS moved that the Alaska Retirement Management Board adopt Resolution 2011-08 approving the Absolute Return Investment Policies and Procedures revised to reflect the staff recommendations. MS. HARBO seconded. The motion passed 5-0, with trustees Harbo, Trivette, Richards, Williams and Schubert present.

12. Contribution Rates for Fiscal Year 2013

MR. BARNHILL suggested taking up the hybrid defined benefit plan rates first, followed by the PERS and TRS FY13 contributions rates.

Resolution 2011-10 and 2011-11

MS. HARBO moved that the Alaska Retirement Management Board set fiscal year 2013 rates for the Public Employees' Defined Contribution Retirement Plan Retiree Major Medical Insurance and the Public Employees' Defined Contribution Retirement Plan Occupational Death and Disability Benefit, as set forth in Resolution 2011-10 and Resolution 2011-11. MR. TRIVETTE seconded. The motion carried 5-0, with trustees Trivette, Richards, Harbo, Williams and Schubert present.

Resolution 2011-13 and 2011-14
MR. TRIVETTE moved that the Alaska Retirement Management Board set fiscal year 2013 rates for the Teachers' Defined Contribution Retirement Plan Retiree Major Medical Insurance and the Teachers' Defined Contribution Retirement Plan Occupational Death and Disability Benefit, as set forth in Resolution 2011-13 and Resolution 2011-14. MR. WILLIAMS seconded. The motion passed 5-0, with trustees Williams, Richards, Harbo, Trivette and Schubert present.

Resolution 2011-09
MR. RICHARDS moved that the Alaska Retirement Management Board set fiscal year 2013 Public Employees' Retirement System actuarially determined contribution rates attributable to employers consistent with its fiduciary duty, as set out in Resolution 2011-09. Seconded by MR. WILLIAMS.

MR. TRIVETTE stated that this was a fairly complicated issue, and the Board heard further testimony from Buck on it yesterday. He apologized that he did not bring the information from the September 2010 meeting with him, and said he did not feel prepared to make a final decision on this. He also noted a minimum quorum of the Board present. He said he wanted to pull out the records of the September meeting, as well as some records from a 2006 meeting. He also wanted all the trustees to have the information from this meeting's minutes in hand before making a decision.

CHAIR SCHUBERT asked deputy commissioner Barnhill if there was any impact from the Board delaying the action until the next meeting. MR. BARNHILL said there was not. CHAIR SCHUBERT said she would entertain a motion to table the motion.

MR. RICHARDS moved to table the adoption of Resolution 2011-09 and 2011-12 until the next meeting. MR. WILLIAMS seconded. The motion carried unanimously.

13. Investment Actions - Private Equity Investment
MR. BADER reviewed the staff memorandum in the packet regarding a $50 million commitment the Board made to Lexington Capital Partners VII, a private equity manager that invests in secondary private equity partnerships, in December 2009. Lexington has done a very good job of investing the money in that short period. He explained staff's recommendation to allocate another $25 million commitment to Lexington, if the firm has the capacity to accept it. *[memo on file at the ARMB office]*.

Tom Newby from Lexington gave the Board a report on the first day of this meeting.

MR. TRIVETTE moved that the Alaska Retirement Management Board approve an additional $25 million in private equity commitment to Lexington Capital Partners VII, L.P. MS. HARBO seconded.

For the benefit of Mr. Williams, who did not get to hear Lexington's presentation, MR. TRIVETTE said he was extremely happy with their report. Lexington was a great find by Callan Associates and the ARMB staff, and he was very comfortable with the decision to allocate another $25 million.

MR. BADER described the process whereby Mr. Gary Roberton of Callan and Mr. Hanna are constantly watching for potential private equity investments where the ARMB could be a direct investor with a partnership. Mr. Hanna brings the firm's name to Mr. Bader, and they read the offering memorandum and other important documents. If Mr. Bader, Mr. Hanna and Mr. Robertson are in agreement that it looks like a potential investment, then they do an on-site visit where they thoroughly review the internal controls and processes used by the investment manager. When they decide they are about to make a commitment, they notify the board chair, and absent any caution to the contrary they then proceed with the commitment. He stressed that these investments are not made lightly.

MR. WILLIAMS asked if an additional commitment to Lexington fit well within the targets for private equity in terms of meeting the Board's goals. MR. BADER responded that currently private equity is slightly over the target allocation for this fiscal year. The allocation to private equity will increase by 1.0% on July 1, the beginning of the next fiscal year, and private equity will be very close to target at that time. Once a commitment is made, the ARMB will be called upon for the money at some point, but it does not necessarily mean that Lexington will invest all the money immediately. At best, the commitments are an estimate of what the total retirement fund assets will be and what will happen in the equity market, and things of that nature. This is an attractive investment, but $25 million is not going to move the needle much.

Noting that Lexington had invested about $18 million of the ARMB's first $50 million commitment, MR. WILLIAMS asked if staff anticipated that the ARMB was going to get to the full investment. MR. BADER said he believed Lexington would get fully invested because there is a lot of opportunity, however, he could not say how soon that would happen.

CHAIR SCHUBERT asked if this request was coming to the Board because it exceeded the $50 million limit placed on the chief investment officer's discretionary authority. MR. BADER said the item was coming to the Board because there was time to discuss this potential investment at a board meeting, and he would much prefer to have full disclosure of what staff was planning to do, rather than act strictly under the CIO authorization.

CHAIR SCHUBERT asked Mr. Bader if the $50 million authority the Board granted to the CIO for private equity investments was sufficient or if it should be raised. MR. BADER replied that if the authority were raised to $75 million, there was no requirement for him to commit to $75 million. However, granting staff greater authority to act seems to be the trend in a lot of funds. He uses the authority granted by the ARMB sparingly. He suggested reviewing that particular policy the next time the Board reviewed its policies. CHAIR SCHUBERT said she was actually thinking of $100 million.

MR. JOHNSON stated that where that cutoff might be is probably in the eye of the beholder. But the Board's mandate under the statutes provides that "the board invests," unlike the Alaska Permanent Fund statutes where "the Corporation invests." The APFC statute distinguishes between corporation versus board when talking about their duties. He suggested, under the scenario of the Permanent Fund, that there is probably greater range for delegation of some of the core responsibilities. From the ARMB's perspective, he suggested caution in terms of a delegation of the statutory mandate that it is the board that invests.

CHAIR SCHUBERT remarked that the retirement fund is a $20 billion fund, and $100 million is not a huge amount.

When called upon to vote, the motion carried unanimously, 5-0.

14. Investment Advisory Council Appointment

The Board prepared to interview Dr. Craig Wisen and Dr. William Jennings for a seat on the ARMB Investment Advisory Council. MR. BADER reviewed the search process that led to the selection of the two finalists.

MR. JOHNSON mentioned the case law that provides that the interview is public but that board deliberations comparing one candidate with another could, if the Board chose, be done in executive session. The vote on selection should be done in public.

Board members Schubert, Trivette, Harbo, Richards, Butcher and Williams interviewed first Dr. Jennings and then Dr. Wisen, asking them a series of prepared questions. *[The interviews were recorded and the record is on file at the ARMB office.]*

14(a). Executive Session

<u>MR. WILLIAMS moved that the Board enter into executive session for the purposes of personnel matters, and that the executive session be limited to</u>

board members and staff of various State agencies. MS. HARBO seconded. The motion passed unanimously.

The teleconference was disconnected, and members of the public left the room while the Board deliberated.

The executive session started at 10:42 a.m., and the regular session reconvened at 10:56 a.m.

14(b). Board Selection/Appointment
MR. TRIVETTE moved that the Alaska Retirement Management Board hire Dr. William Jennings on the Investment Advisory Council for a three-year term beginning July 1, 2011. MS. HARBO seconded. The motion carried unanimously, 6-0.

UNFINISHED BUSINESS

1. Meeting Calendar
MR. RICHARDS moved to adopt the ARMB 2012 meeting calendar as proposed. MS. HARBO seconded.

MS. HARBO made sure that everyone understood the version of the calendar being adopted showed April 19-20, 2012 as the April meeting date.

The motion carried unanimously, 6-0.

2. Disclosure Reports
CHAIR SCHUBERT indicated that the disclosure memo listing financial disclosures was included in the meeting packet.

3. Legal Report
MR. JOHNSON said he had nothing to report.

NEW BUSINESS

MR. BADER stated that the Sustainability Committee had scheduled a meeting the day before the September board meeting in Fairbanks. He asked members of other committees that are scheduled to meet that day to look at their calendars in case there was a conflict.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS - None.

INVESTMENT ADVISORY COUNCIL COMMENTS

The Chair had excused the one IAC member at 10:00 a.m., and the other left following his interview.

TRUSTEE COMMENTS

MR. TRIVETTE apologized to fellow trustees and the Department of Administration for disrupting the process of approving the contribution rates the first day of the meeting and deferring action until September. He said he appreciated the work done at the planning session last week and looked forward to making the meetings more productive through some changes that were discussed. Lastly, he preferred to have all the Anchorage meetings at the Convention Center, as opposed to the customary hotel, because it was more comfortable and had better acoustics.

FUTURE AGENDA ITEMS

MR. BADER stated that Barbara Sheinberg, who facilitated the Board's planning session last week, would be transmitting a draft copy of her report to staff within a week or two. Staff would then provide that report to the Board. Staff plans to implement as much as possible the board-suggested changes at the September meeting, and he hoped shorter manager presentations and expanded educational items on the agenda would meet with trustee approval.

MR. TRIVETTE asked Mr. Barnhill to request additional information from Buck Consultants in writing that they provided verbally during yesterday's actuarial valuation report, and that trustees be provided that information prior to the next meeting. MR. BARNHILL indicated he had asked Buck to provide the level dollar figures going forward and not a recast, but he would do that.

ADJOURNMENT

There being no objection and no further business to come before the board, the meeting was adjourned at 11:00 a.m. on June 17, 2011, on a motion made by MS. HARBO and seconded by MR. WILLIAMS.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary

Note: An outside contractor recorded the meeting and prepared the summary minutes. For in-depth discussion and more presentation details, please refer to the recording of the meeting and presentation materials on file at the ARMB office.

Confidential Office Services
Karen Pearce Brown
Juneau, Alaska