State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

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

MINUTES OF
June 21-22, 2012

Thursday, June 21, 2012

CALL TO ORDER

VICE CHAIR SAM TRIVETTE called the meeting of the Alaska Retirement Management Board (ARMB) to order at 9:06 a.m.

ROLL CALL

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

Board Members Present
Gail Schubert, *Chair (arrived shortly after roll call)*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Commissioner Bryan Butcher *(had jury duty - arrived at noon)*
Kristin Erchinger
Commissioner Becky Hultberg
Martin Pihl

Board Members Absent
2 vacant seats

Investment Advisory Council Members Present
Dr. William Jennings
Dr. Jerrold Mitchell
George Wilson

Department of Revenue Staff Present
Angela Rodell, Deputy Commissioner
Gary M. Bader, Chief Investment Officer

Pamela Leary, State Comptroller
Zach Hanna, State Investment Officer
Steve Sikes, State Investment Officer
Scott Jones, Asst. State Comptroller
Judy Hall, Board Liaison

Department of Administration Staff Present
Mike Barnhill, Deputy Commissioner
Jim Puckett, Director, 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.
Chris Poag, Alaska Department of Law *(by telephone)*
Jonathan Roth, Abbott Capital Management, LLC
Tim Maloney, Abbott Capital Management, LLC
Amber Christman, BlackRock
Chris Barr, BlackRock
James McCandless, UBS Agrivest LLC
David Slishinsky, Buck Consultants
Monica DeGraff, Buck Consultants
Kristin Gaspar, Eaton Vance Management
Brian Dillon, Eaton Vance Management
Oliver Williams, Hancock Agricultural Investment Group
Paul Joerger, Hancock Agricultural Investment Group
John Alcantra, NEA-Alaska

PUBLIC MEETING NOTICE

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

APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda. MS. ERCHINGER seconded the motion. The agenda was approved.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

JOHN ALCANTRA of the National Education Association of Alaska and the Alaska Public Pension Coalition stated that SB 121 passed the Alaska Senate, 14-6, near the end of the legislative session. The bill provided an option for defined benefit or defined contribution, with additional contributions from most public employees. He encouraged board trustees to read the legislation. On behalf of the Alaska Public Pension Coalition, he thanked all the legislators — and specifically Senators Dennis Egan, Bill Wielechowski and Bert Stedman, along with their staffs — who tried to make SB 121 as perfect as possible. He thanked the Alaska Department of Administration for providing access to their actuary. He said he was hopeful there would be a pre-file of a similar piece of legislation for January 2013.

APPROVAL OF MINUTES - APRIL 19-20, 2012

<u>MS. HARBO moved to approve the minutes of the April 19-20, 2012 meeting as presented</u>. <u>MS. ERCHINGER seconded</u>. Without objection, the minutes were approved.

REPORTS

1. Committee Reports

1(a). Audit Committee

Audit Committee Chair MARTIN PIHL reported that they met June 20 and received KPMG's audit plan for this year *[copy of the minutes is on file at the ARMB office]*. They also received the Division of Retirement & Benefits Division detailed schedule to complete the audit. There are no significant accounting or SEC changes being faced this year. June is when the committee gets its report from legal counsel, Rob Johnson, and there were no issues it confronted. Pam Leary presented the Treasury Division report on what was a clean independent audit of State Street, the custodian for the retirement funds and State funds. She also discussed the Treasury organization chart and staffing for work done on behalf of the ARMB. Lastly, the committee continues to receive a monthly investment compliance report from Treasury, and there have been no significant findings over the course of time.

2. Chair Report

CHAIR SCHUBERT said she was a little under the weather and apologized for being late. She reported receiving an email message from Mike Williams stating that the Governor did not reappoint him to the Alaska Retirement Management Board. Mr. Williams asked her to pass along his gratitude and appreciation to the Board and staff for all their hard work, and he wished the Board every success in dealing with the difficult issues in maximizing investment returns and meeting the obligations of the retirement fund.

3. Retirement & Benefits Division Report

3(a). Buck Consultants Invoices

Division of Retirement & Benefits Director JIM PUCKETT indicated that the fiscal analysis, etc. that Buck did on legislative bills would be paid with some lapsed General Fund money in the Division budget. He also reported that the Division retained Buck Consultants to do a consulting study on a consolidation project that cost $164,692, also to be paid from the Division budget *[presentation to follow]*.

MR. TRIVETTE said he applauded the Division of Retirement & Benefits for the study to look at the increasing workload with the same number of employees. He also suggested that the Division amend the Buck Invoices report to remove the items that have been paid off out of lapsed funds.

3(b). Membership Statistics

The report on membership activity as of March 31, 2012 was included in the meeting packet.

3(c). DRB Update

MR. PUCKETT reported on some major changes that will take place in the Division of Retirement & Benefits *[slides on file at the ARMB office]*. Given the projected growth in the PERS and TRS retiree population, DRB is facing a much larger workload than it has had in the past ten years. The Division engaged Buck Consultants to analyze the coming workload and provide some options for Division management to consider. Management is pleased with the quality of Buck's work and believes it got quite a bit for the money. Buck reported that the retiree population will grow from the current 37,000 to approaching 60,000 in 12 years. The Retirement Processing Unit processed 2,176 retirees in 2011, the largest number of retirement applications in one year since the time when some school districts and municipalities offered an early retirement program.

MR. PUCKETT stated that Buck Consultants are very experienced in analyzing retirement systems across the country, and they included a statement in the final report to DRB that, "We have rarely seen such dedication and personal identity with one's work as we found within the DRB..." He said the people in the Division take the work very seriously because Alaska is a small community, and the work is personal for them.

He presented the current structure of the Retirement and Benefits Sections, the two sections that most people are in touch with when they contact the Division. Of the three options that Buck suggested to make the Division more efficient in an attempt to meet the workload, the most painful choice to implement was the one that MR. PUCKETT said he recommended to the commissioner. That was to merge the Retirement and Benefits Sections and eliminate the redundancies in the appeal unit, the call center unit, the processing unit, etc. Buck recommended forming one large section that will be called Member Services, with a Call Center Team, a Counseling Team, an Appeals Team that will handle both benefit and retirement appeals, and an Operations Team that will handle death and disability, retirement processing, and benefit processing. The culture of the new section will be to guide Alaskans to make the right decisions for a lifetime of well-being.

MR. PUCKETT stated that the Division is also in the first phase of an imaging project to convert all the microfiche records into digital documents that will be available to the customer service representatives in real time.

COMMISSIONER HULTBERG said the benefit of doing the reorganization is to be able to eventually free up positions that can then be redeployed back into the division where they are needed. So while the analysis by Buck was an upfront cost, it will save the Department of Administration from having to ask approval to create new positions to accommodate the increased workload.

CHAIR SCHUBERT remarked that the imaging project was a tremendous move forward that will probably benefit the beneficiaries of the system, because they will be able to get immediate answers instead of having to wait for customer service representatives to research the records and call back.

4. Treasury Division Report

Deputy Commissioner ANGELA RODELL reported that the Pension Obligation Bond Corporation met on June 5, and Trustee Trivette was also present. She said the fiscal year ends June 30, and she hoped that the investment performance of the retirement fund would continue to recover from the ugly markets over the last month and a half.

CHAIR SCHUBERT referred to recent news reports about state funds not following the governor's wishes to divest in Iran investments. She hoped that the governor understood that it was not out of disrespect to him but that it is a fiduciary obligation that the ARMB has to the retirement fund and the beneficiaries. She said staff did communicate with the investment managers.

MS. RODELL responded that the message had been conveyed, and the governor understands and appreciates the Board's position in this matter.

5. CIO Report

Chief Investment Officer GARY BADER reported the rebalancing of assets between pools to bring them into alignment with the board's target asset allocation. Twenty million dollars were also transferred from the TIPS account to Advent Capital Management (convertible bond account). The meeting packet contained communication from Blair Thomas of EIG Global Energy Partners.

MR. BADER informed the Board that Al Clerc had resigned from Pathway Capital Management and had been replaced by Jim Chambliss, who has been on the ARMB account for several years. Staff does not find this change to be of concern and believes the portfolio will continue to be managed as it has been in the past.

The Board had previously authorized staff to engage a risk manager to help assess risks in the portfolio: staff has decided to resolicit for a risk manager that will provide more analysis that is independent of staff input.

Assistant investment officer Elizabeth Walton working in the fixed income unit will be moving to the cash management unit. MR. BADER said he has approval from the Governor's Office to begin a search for a replacement.

MR. BADER said Ms. Erchinger had inquired about the manager watch list report at the last meeting. His written report included a list of the firms that are on the watch list, which he reviewed in more detail:

- Coventry Real Estate and Lehman Real Estate are both contractual funds that experienced stress during the most recent real estate decline. Staff had written Coventry down to zero, but a few years of positive audits prompted staff to write the fund back up to the auditor's value. Lehman has been renamed Silver Peak, and the ARMB's assets are performing currently.
- Lord Abbett is a small cap equity mandate. For the calendar year ended 3/31/12, it beat the index by 110 points. Over the last three years the portfolio has underperformed, but over five years it has outperformed and over 6-1/2 years it has underperformed. Staff recommended keeping Lord Abbett on the watch list and not taking any action at this time.
- Hancock Agricultural was placed on the watch list because its president, Jeff Conrad, had resigned. The new president is Oliver Williams, who has worked on the ARMB account since the beginning. There have been no issues on the account, and staff recommended that Hancock be removed from the watch list.

<u>MS. HARBO moved to remove Hancock Agricultural Investment Company from the Manager Watch List</u>. <u>MR. PIHL seconded</u>. The motion passed unanimously, 6-0.

- McKinley Capital's international equity mandate is on the watch list. The international portfolio was below the EAFE Index by 123 basis points in 2011. The two-year return was 201 basis points above the index return. McKinley knows their performance would be a topic of discussion with the board, and they have visited with staff and explained why they think the market is cycling back to when their style will be back in vogue. Given the mixed results from McKinley, staff recommended keeping them on the watch list for the international equity mandate. It is especially costly to terminate international equity mandates, and currently the retirement fund is underweight international as it is.

MR. BADER said that he had spoken to the Investment Advisory Council about the amount of emerging markets that is represented in the EAFE mandates. Many times over the years managers have reported to the board that they have increased the amount of their emerging markets exposure. Since the ARMB has emerging market mandates with some managers, there is a risk of having far more emerging market exposure in the portfolio than is intended. After consulting with the IAC and Callan Associates, staff will be coming to the board with a recommendation to constrain the developed countries mandates on the amount of emerging markets they should be in.

- McKinley Capital's large cap growth mandate outperformed the Russell 1000 Index by 237 basis points during the last year, and outperformed by 255 basis points for the past two years. But the three-year return is 129 basis points below the index. [Staff believes the three-year return guideline for putting a manager on the watch list needs to be researched and discussed at a later date.] Staff recommended that McKinley's large cap growth portfolio be maintained on the watch list, but noted that their recent performance is in the right direction.

- The internally managed REIT fund passes all three tests for not being included on the watch list. It has outperformed the index for the past two years. Staff requested that the REIT fund be removed from the watch list.

MS. HARBO moved that the Board remove the REIT fund from the Manager Watch List. MR. TRIVETTE seconded. The motion carried unanimously, 6-0.

- MR. BADER said that Prisma Capital recently announced they were going to be acquired by KKR. The terms of the acquisition are as favorable as one could expect from an investor standpoint, and all the people at Prisma are going to remain in place. The watch list qualitative requirements dictate that Prisma should be placed on the watch list.

MS. HARBO moved that the Board place Prisma Capital on the Manager Watch List because of ownership change. MR. TRIVETTE seconded. The motion passed unanimously.

MR. BADER stated that the Capital Guardian Emerging Markets Fund return was 444 basis points below the index last year. For the last three years it was 615 basis points below the index return. Over the past seven years it has outperformed the index by 74 basis points. Capital Guardian underperformed the index in 15 of the last 20 quarters. Staff recommended that the ARMB exit the Capital Guardian Emerging Markets Fund because of performance. He said the retirement fund was underweight global ex-US investments, so any withdrawal from Capital Guardian should be re-invested: staff's proposal was to allocate the funds to one of the index managers (Barclays/BlackRock or State Street) and perhaps some to the Lazard global mandate. He said staff did not like to be in the position of asking for this action, but the Capital Guardian Emerging Markets Fund had been the topic of discussion with the Investment Advisory Council.

IAC member JERROLD MITCHELL said he was in favor of Mr. Bader's recommendation. He said the world of emerging markets has changed from the days when Capital Guardian was the first major firm to manage emerging markets. They have grown bigger, but they have not changed the way they do things. Meanwhile, the emerging markets management area has changed dramatically so that there are managers within each emerging market country who are very good and who have better access to information, who are smaller and quicker on their feet. Also, there are other U.S. firms that have gone into the emerging market area with analysts as good as Capital Guardian. He said that he has great respect for the people, the management, and the way that Capital conducts itself as a company, but he did not think that they would ever be able to keep up with the index in the future. So the ARMB might as well index the assets.

CHAIR SCHUBERT asked if staff had a second recommendation for the distribution of the funds. MR. BADER requested discretion in the timing of selling assets from terminating Capital Guardian's emerging market mandate.

MS. HARBO moved that the Alaska Retirement Management Board terminate the Capital Guardian Emerging Markets Fund and grant staff latitude in timing the termination. MR. PIHL seconded.

On a roll call vote, trustees Erchinger, Harbo, Hultberg, Pihl, Trivette, and Schubert voted in the affirmative. The motion passed unanimously.

MR. BADER recommended that the funds from Capital Guardian be placed into either State Street or BlackRock/Barclays international index funds, and to authorize Callan Associates to do a search for a new international manager. He added that the ARMB has large sums invested with Brandes and Lazard, and McKinley Capital is on the watch list, so the Board probably needed another manager in that area.

MR. TRIVETTE moved and MS. HARBO seconded.

MR. JOHNSON stated that the motion as presented was that the redistribution of assets be made to one or the other of State Street or BlackRock/Barclays. He said the motion would have to be changed if staff wished to have flexibility to split the assets between the two.

MR. BADER said his intent was to have flexibility, but he could nail it down to the State Street Index Fund.

The maker and second on the motion accepted the amendment to limit the distribution of assets to State Street.

MS. ERCHINGER inquired if there was any concern that the volume of assets from Capital Guardian would be prohibitive for State Street for some reason, such that staff would want the added flexibility to have more than one option to place the assets.

MR. BADER said he was not concerned about State Street. He added that BlackRock, also an index manager, was making a presentation later, and he was trying to preserve some flexibility if the Board had a preference. He said both of the managers do a great job, staff has been very satisfied with this type of work that State Street does, and staff is very satisfied with placing the assets there.

MR. PIHL inquired about the amount of ARMB's assets in the emerging markets fund at Capital Guardian. MR. BADER said just shy of $400 million.

The roll was called, and the motion passed unanimously, 6-0.

6. Fund Financial Presentation

State Comptroller PAMELA LEARY reviewed the April 30, 2012 financial report for each retirement plan. The total retirement fund assets grew 1.92% for the first ten months of the fiscal year. The increase was a result of investment income of $421 million. There were net withdrawals due to benefit payments coming out of the defined benefit retirement plans. The invested assets experienced a loss of 0.47% for the month of April, and there were also net withdrawals for the month.

MS. LEARY indicated that May was not a great month for the investments, resulting in the total retirement fund assets being almost 2% under what the fiscal year started out with.

The report included graphical depictions of the asset allocation and invested assets growth/loss for each retirement plan. Also contained in the report were the individual investment manager results and information for the participant-directed plans.

MR. PUCKETT presented the supplement financial report prepared by the Division of Retirement & Benefits.

MS. ERCHINGER said she would be interested in getting in the future a deeper dive on the administrative and investment costs, in particular what those costs are for the Alaska pension plans versus comparative plans.

MR. PIHL requested more information from DRB on refunds, which he believed was $167 million in ten months, and what people are doing.

CHAIR SCHUBERT called a scheduled break from 10:08 a.m. to 10:21 a.m.

5. Revisited - CIO Report

MR. BADER said he had misunderstood Mr. Johnson's comments earlier and meant to say that he wanted the authority to place the assets from the Capital Guardian Emerging Markets Fund with either State Street or BlackRock/Barclays, or both those index managers. He asked the Board to give staff that latitude, saying that it perhaps gave staff some leverage in terms of negotiating fees, and it certainly provided a certain degree of mitigation of risk by having assets in two different places.

<u>MR. TRIVETTE moved to reconsider Motion #5 dealing with the placement of the Capital Guardian Emerging Markets Fund proceeds</u>. <u>MS. HARBO seconded</u>. The motion passed unanimously.

CHAIR SCHUBERT stated that the motion was back on the table and open for an amendment.

<u>MR. TRIVETTE moved to amend the motion to allow staff latitude to place funds with either State Street or BlackRock/Barclays or both</u>. <u>MS. HARBO seconded</u>. The motion to amend passed unanimously.

<u>CHAIR SCHUBERT stated that the main motion was on the table, and asked that all those in favor of passing the motion to say aye</u>. The motion carried unanimously.

MR. BADER said he neglected to mention RCM Capital Management in the Watch List report. RCM's large cap mandate fails to pass the test, and he recommended placing the manager on the Watch List. RCM outperformed the S&P 500 Index for one year by 57 basis points and for four years by 221 basis points. However, by the watch list's three-year quantitative test RCM is below the index return by 117 basis points.

<u>MS. HARBO moved that the ARMB place RCM large cap equity mandate on the Manager Watch List</u>. <u>MS. ERCHINGER seconded</u>. The motion passed unanimously.

7. Investment Performance - First Quarter 2012

MICHAEL J. O'LEARY of Callan Associates, Inc. gave the report on the retirement fund's investment performance as of March 31, 2012 *[a copy of the slide presentation is on file at the ARMB office].* Callan's PAUL ERLENDSON was also present and provided information on the individually managed accounts.

MR. O'LEARY said that after a good first quarter for the markets, followed by a poor May and then some recovery in June, almost all equity indices were positive on a calendar year-to-date basis. He showed charts of data on the economy, pointing out that the inflation rate seemed to have declined. The pace of the economic recovery is so slow that there have been no real improvements in domestic employment. Some private sector employment numbers have picked up a bit; however, the labor force expanded so that instead of the unemployment rate going down it rose a little in the most recent month to 8.1%. It would not be surprising to see that pattern continue.

Regarding a chart of U.S. Treasury yield curves for three points over the 12 months ended March 31, MR. O'LEARY said the flight to quality went away a little bit during the March quarter. However, the lower current yields demonstrate how afraid investors became subsequent to the March quarter end, primarily driven by the continued turmoil in Europe and fear that China and some other emerging economies are slowing down, and that that will spill over to the U.S. domestic economy. Callan's view is that there will continue to be slow but positive growth in the U.S. Some would say that Europe is already in recession and that the U.S. is also turning into recession; however, Callan believes it is premature to say that.

Credit spreads narrowed during the first quarter of 2012 (so corporate bonds did better than the Treasury bond of the same maturity). That had clearly not been the case during much of last year. Spreads also narrowed for emerging market bonds in the quarter, but on a trailing 12-month basis it is a less compelling case. This is important in understanding the performance of a manager like Mondrian that is a non-US government bond manager but which the ARMB has granted the flexibility to own a portion of the portfolio in emerging market debt. That has helped Mondrian on balance since they had the ability to do it, but it really detracted from performance during the past year.

MR. O'LEARY presented Callan's periodic table of investment returns for various time periods ended March 31, 2012. He also spent a few minutes explaining the returns for domestic and foreign developed market indices as measured in local currency terms and in dollar terms, and the impact of the ARMB's asset allocation.

Real estate continued to improve in the first quarter, although the pace of improvement slowed a bit. The NCREIF Property Index 12-month return of 13.4% was terrific. Public real estate also had a very strong absolute return, at 12.8%.

Using PERS as the example, MR. O'LEARY presented the retirement plan actual asset allocation at March 31 compared to the strategic target allocation. At that time, the fund was overweight to domestic equities and private equity and underweight to fixed income and absolute return. He also compared the retirement plan asset allocation to that of other public funds.

The total retirement fund returned 7.97% for the March quarter, beating the target return of 7.48%. The trailing 12-month return of 4.53% was also ahead of the benchmark's 4.44% performance. Over the three-year period the total fund's 14.5% return trailed the target return of 16.4%. Private equity was the biggest source of return difference over that three-year period, and much of that is attributable to the timing of results reported by private equity funds.

MR. O'LEARY next commented on major asset categories, as follows:

- The total bond portfolio did slightly better than target for fiscal year to date and the 12-month period.
- The in-house intermediate Treasury portfolio had spectacular performance for the 12 months.
- The non-US fixed income (Mondrian) had a strong March quarter relatively, but the trailing nine months of the fiscal year was below the benchmark. Over three years, Mondrian had very strong performance, and the longer-term record is outstanding.
- High-yield bonds (MacKay Shields) have done well recently. They have higher quality high-yield bonds in their portfolio: this hurt them in the first part of the recovery, where the real "junk" was selling at incredibly distressed values. MacKay Shields did not participate as meaningfully in that snapback, but in this more measured environment they have done very well. For all the periods, the Board's decision to have high yield be part of the fixed income portfolio was a good decision as MacKay Shields' results have been above the Barclays Aggregate. They have beaten their high yield target out to two years but have been below it for the longer periods.
- The total domestic equity pool did better than median for the fiscal year-to-date and the last 12 months.
- The large cap domestic equity pool has a large portion passively managed, so results are close to median. Callan is currently breaking down the active and passive domestic equity and will be meeting with staff and the IAC on that. A

byproduct will be greater ease in understanding what has contributed to the performance picture.

- The small cap equity pool has done better than the benchmark out to five years.
- Convertible bonds and option strategies are a subcategory of the total equity pool. The expectation is that these will do better than the market in weak market environments and will underperform in strong market environments. That is dramatically evident with the Analytic Buy-Write strategy.
- Total international equity was down 5.62% for the year, while the target MSCI ACWI ex-US Index was down 6.75%. The five-year number is also slightly negative but "less bad" than the target index. Seven years is better than the index, and the 10-year trails the target index a bit.
- The performance of the international equity managers, excluding the emerging-markets-only managers, has been superior to the target MSCI EAFE Index, despite the fact that emerging markets underperformed developed markets over the past year and the ARMB international managers have had emerging markets exposure.
- The emerging markets equity pool did a tad better than the target for the full year, although both numbers were negative.
- Lazard is the sole global equity manager, and their performance during the year was extraordinarily good — 3.36% against a negative target index return.
- The real assets category on a full calendar year basis had a preliminary return of 14.06%, with a target return of 12.25%. The timber category has not done as well as the farmland category. TIPS have been quite spectacular. The energy funds have been a drag on performance recently, but the 10.3% return over five years is very attractive.
- The absolute return composite over 12 months had a negative return of 96 basis points, which was essentially at the median of Callan's database.

MR. O'LEARY said he also included a summary of comments on investment managers in the report.

MR. ERLENDSON presented a "stoplight" performance spreadsheet for the balanced and target date funds that are available as individually managed account options. He pointed out that almost 40% of the total assets in the SBS (Supplemental Benefit System) are in the Alaska Balanced Fund and the Long-Term Balanced Fund. All the investment options beat their benchmarks for the quarter, with the exception of the Long-Term Balanced Fund, which was at the 52nd percentile. All the funds are being quite successful in achieving the objectives for which they were created.

Regarding what participants are doing with their money, MR. ERLENDSON reported that during the first quarter $4.9 million net was added to the Long-Term Balanced Fund — the largest amount of money into any of the individual funds. On the flip side of that equation, nearly $10 million exited the Alaska Balanced Fund.

MR. BADER remarked that the Alaska Balanced Fund appeared to be outperforming its passive index, and he wondered why the three-year return was red in the "stoplight" report. MR. ERLENDSON explained that it ranked in the 93rd percentile compared to what others call a balanced fund over the last three years. He added that when he looked at that, it was because the Alaska Balanced Fund has a low equity allocation. The three-year performance captures the big recovery of equities in 2009. But the five-year return includes the collapse of the equity markets in 2008 and has the fund in the top 8%.

MR. ERLENDSON next reviewed the performance of the passively managed investment options for participant-directed accounts. He pointed out that even though the Long-Term U.S. Treasury Bond Index beat its benchmark during the first quarter of 2012, it was down 5.9% in the quarter as interest rates rose. In contrast, that long-term fund was up over 25% in 2007. That is the dilemma that investors who are not fully engaged all the time run into: they look at what did well and put their money there, and when it doesn't do well they take their money out. In fact, in the March quarter there were net outflows of over $6 million, as people saw a bad outcome and moved their money out.

MR. ERLENDSON moved on to the performance of the actively managed options (active equity, stable value and interest income). He mentioned that investment results alone may not be the primary reason that people invest in the RCM Socially Responsible Fund. The social screens significantly reduce the universe of available investment opportunities, and this type of fund tends in some cases to exclude certain industries and overweight other industries relative to the broad market. It results in a highly specialized sector exposure fund, and it may be that people who invest in these strategies are not fully cognizant of the investment risks they take by acting on their beliefs. At March 31, a little under $31 million was invested in the RCM Socially Responsible Fund. With the exclusion of RCM, actively managed funds have been doing very well recently and essentially meeting their objectives.

To wrap up, MR. O'LEARY provided comment on the market environment. He said people have been preoccupied with the impending fiscal monetary cliff, the Fed's decision to continue Operation Twist, and the continuing issues in Europe. On balance, people are infinitely better off than they were in September 2008, in terms of risks to the financial system. When looking at measures of valuation and the ability to cope with things, one could make a fairly strong case that five years down the road they would be happy they maintained equity types of investments. The markets today reflect the very serious problems that the world economy is faced with. He said he thought that, on balance, the ARMB had very good managers that were well equipped to deal with it.

IAC member GEORGE WILSON said he echoed Mr. O'Leary's comment. An important point to focus on is that the bond market was the place to be for the last 10 or 12 years. But today cash is zero, and the 10-year Treasury is at 1.6%. The ARMB is a long-term investor. He hoped that over the next 10 or 15 years the stock market will be the place to be invested. He said his recent research showed that the worst period ever in the stock market was the 10-year period ending 2008, and it was a negative 1%. Every other 10-year period is at least zero. The worst one could do is a money market rate of return if the odds continue to play out that way. However, he thought equities were the place to be.

8. Abbott Capital Management, LLC

Abbott's president, JONATHAN ROTH, and managing director TIM MALONEY, joined the meeting to talk about the private equity portfolio the firm has managed for the ARM Board since September 1998. *[A copy of the Abbott slides is on file at the ARMB office.]*

MR. ROTH stated that the rapid changes in the market moods and dispositions affect private equity, even though private equity is a long-term asset class. As private equity practitioners are trying to make new investments that they will try to grow value over five, six or seven years, or if they are in that fifth, sixth or seventh year and trying to capitalize on all the work they have done, they have to be able to nimbly pick the right time in the market to transact, be it on the buy side or the sell side. In 2011 the market conditions were fairly conducive for both buyers and sellers on the whole, but there was really a first half and a second half to the year. In the first half things were feeling much better, and in the second half of the year Abbott saw the credit markets come to a halt and the venture capital/IPO market essentially slam shut between July and November. But the all-year statistics tell basically a good story, and the ARMB portfolio generated nice results.

MR. ROTH said that in the first quarter of 2012 they saw robust investment activity and robust divestment activity, and the ARMB's cash flows reflected that. However, the market conditions from the middle of April through today have an IPO market that has been closed since May. That is mostly due to a fair amount of discussion about the poor after-market performance of a number of high profile IPOs, companies that went public in the fall of 2011.

The venture capital market was healthier but feels a little bit less healthy today. However, some recent strategic acquisitions suggest that the tilt from IPO as an exit is now back to mergers and acquisitions (M&A).

MR. ROTH stated that the deal activity level was fairly good through 2011. In the most recent quarter, and particularly in Europe, Abbott is seeing almost a grinding halt in private equity buyout transactions. That is mostly due to it being almost impossible to secure debt financing along with buyouts, notwithstanding the strategic acquisition that Walgreen's is making to buy an interest in Boots. On the private equity exit side, the notion that the IPO is a viable option is certainly questioned. As a result, there are many more sponsor-to-sponsor transactions as an exit option, now constituting roughly 12-13% of the total private equity market.

MR. ROTH echoed Mr. O'Leary's sentiments about the risk-on/risk-off type of market mood swings. He said there is no way to predict and no way to explain it, other than there are market sentiments that are clearly changing from day to day, week to week, and month to month. General partners trying to take a company to market need to have some certainly on financing, and the challenge is that that certainty just does not exist.

In terms of the new deal environment, MR. ROTH said there are companies with high growth rates where valuations could be 12 or 13 times cash flow, and then value plays were companies are being bought for five or six times cash flow. It really depends on the sector and growth opportunity. Within venture, the buzzwords would be social, mobile, cloud, and big data. The dilemma there is a very frothy, late-stage growth equity pricing environment because people were doing anything to get in on the next to last IPO rounds. Even mutual funds began to play highly in these rounds. Now they are faced with looking at some of those prices vis-a-vis where they sit in the public market, and they are under water. There is probably going to be a reset in terms of some valuation metrics. Early stage still seems to be the place to get some incredible "pop" returns, but those pop returns are really getting more and more concentrated with a fewer number of firms. If Abbott cannot be in those firms, they do not want to be in the second or third tier firms. So their venture portfolio tends to be a little bit more growth-equity, with some presence in venture. But they have been very selective in venture and raising the bar.

The healthcare space has been underwhelming and underperforming for Abbott: there has been a lot of press recently the situation in the FDA (Federal Drug Administration) has gotten better, but it is better relative to a fairly tough environment for devices and drugs getting approved.

MR. ROTH next spoke on the private equity fundraising environment. Abbott's tactical plan that the Board reviewed at the April meeting approved them for $135 million target for 2012. There is clearly a bifurcation, and existing funds that are doing extremely well are able to raise reasonably sized pools of capital. Abbott has tended to be underweight the large mega strategy firms like Apollo, Blackstone and Carlyle, and they may not continue to be even as active as they have been on that upper end of the market. Abbott prefers more the middle to lower middle market in private equity.

MR. ROTH said there has been a fair amount of talk about institutional limited partner best practices. But many of the members of Institutional Limited Partners Association (ILPA) have also gone around and cut special deals with general partners. How those special deals are cut is not always the same, and Abbott is watching that carefully. It can result in a partnership with some of the limited partners on one page and some LPs on a different page. The other troubling item that Abbott is watching is the notion of institutions establishing separate accounts with private equity funds.

MR. ROTH stated that the other aspect of private equity that Abbott engages in and that is getting a lot more active is secondaries. They continue to see a good flow of opportunities (to purchase from other limited partners who wish to get out of their partnership commitment in another fund).

The ARMB portfolio has some exposure to Europe, and that is predominantly upper middle market exposure with a select handful of what Abbott calls country focused funds. Many of the funds' portfolio companies could be headquartered in Europe but they actually may be global businesses. Where there is greater risk in the Europe part of the portfolio would be with the smaller funds. On the whole, Abbott is making sure that the general partners are being extremely judicious in terms of how they leverage their portfolios, and they are actually seeing a fair number of exits from this market because these GPs are taking every opportunity to get their money back. New investment activity is on the decline because of all the uncertainty.

To summarize, MR. ROTH said the GPs and the limited partners are in a better place than they were a year ago. They are taking advantage of getting exits when they can, because otherwise they have to be prepared to hold the companies through cycles that may last for a couple of years. Limited partners have seen the benefit of private equity in their portfolios: double-digit returns are hard to find. The ARMB portfolio started in 1998, and the first three years were entering at a high environment. However, the recent returns justify the commitment that the Board made, and liquidity flows remain quite robust.

MR. TRIVETTE inquired what percentage of the ARMB private equity portfolio was invested in small European companies. MR. ROTH guessed that in dollar terms it was collectively around $25 million.

MR. MALONEY presented specifics about the ARMB portfolio. Abbott made several commitments in 2011 totaling $108 million, including to four groups that were new to the ARMB portfolio. The commitments represented about 80% of the target the Board gave Abbott for the year. So far 2012 has been very busy: Abbott has made 11 commitments totaling $102 million out of the total $140 million allocation for this year. A couple of groups are new names: one that focuses on middle market buyouts in Australia, as well as the first commitment to an India located fund.

MR. MALONEY reported that since the portfolio began ARMB paid in about $1.3 billion and has received distributions back of about $1.15 billion. The net IRR is 8.8%, a 64-basis-point improvement from year-end 2010. The portfolio is very diversified, with exposure to almost 2,000 different portfolio companies across the broad spectrum of the macro economy.

MR. MALONEY said Abbott expects a slight slow-down in commitment activity, despite their robust deal pipeline. However, they feel good about being able to hit the ARMB's $140 million target commitment by the end of the year.

Regarding the organization, MR. ROTH stated that there have been no changes to the senior management team. Abbott has added resources to the team in the form of two new associates. Their marketing client services director of four years decided to move to Atlanta for family reasons, so they have just announced a replacement. Lastly, there have been no changes on the client front.

MR. TRIVETTE asked if Abbott expected to see any changes in the organization over the next couple of years. MR. ROTH said they have a "crawl, walk, run" approach to things. However, they have been more active on the secondary side and may consider adding expertise to further improve the deal flow if they see a more ready flow of opportunities that would be additive to the portfolio.

Responding to MR. O'LEARY, MR. MALONEY said the ARMB portfolio contains a couple of "zombie" funds, older commitments done in the first few years of the program with Abbott that have been extended. Abbott is currently working diligently to get these investments wrapped up.

CHAIR SCHUBERT commented that the Board's decision to invest with Abbott in 1998 has proven to be a good decision. She then called a recess for lunch at 11:55 a.m.

The meeting reconvened at 1:15 p.m.

9. BlackRock

AMBER CHRISTMAN, vice president and primary account manager with the ARMB for the past four years, and CHRIS BARR, co-head of the multi-sector fixed income strategy team, addressed the Board about the three index funds they manage for the retirement fund. *[A copy of BlackRock's slides is on file at the ARMB office.]*

MR. BARR remarked that the ARMB had been doing business with BlackRock almost as long as they had been indexing, a relationship they were very happy with. The ARMB is invested in some funds that have actually sliced off of funds that BlackRock has had for 20 years, so there are a lot of seasoned bonds that help get the diversification and the accuracy in tracking error that BlackRock requires. A couple of years ago the legacy Barclays Global Investors (BGI) index franchise merged with BlackRock. The good news was that for ten years BGI had been on BlackRock's Aladdin system, the enterprise risk management system that the government saw fit to give all the assets from the Citicorp/Bear Stearns/Lehman Brothers issues outstanding.

MR. BARR stated that BlackRock has $1.3 trillion in global fixed income under management. Over $600 billion is in passive management, so there is an enormous commitment to the index business. BlackRock's ETF business has traditionally been retail money, but it is just taking the existing fixed income institutional franchise and offering out individual shares. This is relevant to Alaska because it does not dilute the value or performance of what the retirement fund owns at all but actually enhances it: the more bonds, the more flow, the more distribution BlackRock has coming through its institutional business, the better diverse, the better scale and better execution the ARMB gets as index holders.

MR. BARR gave a brief overview of the process that BlackRock uses for fixed income indexing. He stressed that their daily exercise is ensuring that they own enough bonds to get all the diversification to get tracking error to a minimum without paying too much for bonds that are just going to destroy the performance by paying up in transaction costs. He talked about the four parts of BlackRock's index portfolio construction process (either stocks or bonds): (1) detailed benchmark knowledge; (2) index replication process; (3)

efficient trading; and (4) performance analysis. When the ARMB buys a unit of BlackRock's Government/Credit Bond Index Fund, it is actually not buying something in the index. For reasons of efficiency, BlackRock has broken out all the master indices into modules. That allows them to get scale and specialization within each of the sectors, and it allows the ARMB to participate in things like crossing at meaningful cost savings.

MR. BARR also reviewed BlackRock's trade systems, saying that they traded over $6 trillion last year. They have over 120 counterparties that they are trading with — they are the number one counterparty to Wall Street in fixed income.

MR. BARR presented the performance of the ARMB's Government/Credit Bond Index Non-Lendable Fund, which has returned over 7% annualized over the last few years. Rates have been on the ARMB's side for sure, and the Board had a very good entry point in that it was a very hot market when it got into the non-lending fund and spreads were coming in. He noted that the only characteristics that jump out different between the fund and the index are some different yield and different price average numbers. That is because there is a small percentage of cash in the portfolio. BlackRock owns 4,800 issues versus 5,700 in the index, so they own an enormous percentage of the bonds.

MR. BADER asked Mr. Barr to highlight the changes in the progress on the indexing strategy, and he complied. He said the three main things that the ARMB has participated in over the years are: (1) the evolution of information technology for risk management of the portfolio; (2) aggregating trade execution; and (3) putting themselves in the client's shoes to stay out the headlines and to make sure that they only develop and focus on products that they can actually deliver.

MR. WILSON brought up that the tracking error was about 36 fifths per year, and he asked how the Board should view that, because he thought it was on the higher end. MR. BARR replied that BlackRock delivers the risk and return profile that they advertise, and the Government/Credit Bond Index Non-Lendable Fund is a post-notified fund. There are asset flows in defined contribution space, and the ARMB has to notify the asset manager of the flows for the day. So there is a gap between when staff provides the manager with that flow and the value of the fund that BlackRock is executing on. Sometimes the difference between when the orders are posted up and when the retirement fund is receiving the NAV is positive and sometimes it is negative. It is a function of the recordkeeper's abilities. BlackRock's tracking error is well within the range of what they see in defined contribution plans.

MR. BADER mentioned that the Board made the decision to be a non-lending fund several years, and it turned out to be a very timely decision. However, there are revenues lost by not lending the securities.

MR. BARR said that most people who invest in index funds are buy-and-hold investors and do not need the money every day. There are a lot of reasons why other people might want to borrow those securities, which is why securities lending was developed. The money made on lending securities ends up being around 20 basis points, and that revenue is split. If the split is 50-50, that is 10 basis points to the owner of the securities. So if roughly half of the securities in a portfolio are lent, that ends up being about five basis points of revenue. If the question is how much the ARMB loses from being non-lending, it would be about five basis points a year. While BlackRock is a good securities lender, many people look at it as chasing pennies in front of a steamroller. Blackrock recognizes that the retirement fund does not want to get five basis points of securities lending revenue a year and risk losing 1% in a bad year. It is a tough question, because he loves the experience that BlackRock has had with their lending funds, but he has seen other people have a real tough time. The ARMB has done really well with what it has done.

MR. O'LEARY noted that BlackRock had gotten quite a bit of news regarding the crossing of transactions. He asked what was driving the interest in what BlackRock is doing, and how people could be assured that both sides of the trade were being treated equitably.

MR. BARR said that the term "crossing" has meant a lot of things to a lot of people in the past, and people recall scary news in the past decade about dark pools and foreign exchange crossing that were really principal transactions. The bond market is a principal market, and that means somebody is doing a bid and somebody is doing an offer. The spread between the offer and the bid on Wall Street is the transaction cost for buying bonds, and that happens for everybody. BlackRock trades $6 trillion a year, so their spread tends to be a little skinnier than most people's. Crossing in its purest form is that BlackRock does not have to go to Wall Street. The Department of Labor gives BlackRock an exemption that they are allowed to go between funds crossing units. It means they do not have to buy a unit for a client at the offered side (the convention in fixed income is that the NAV is marked at the bid side). In a cross, they get it at the bid side and it saves the client the entire spread. There is no principal transaction and there is no way to get hurt; it is literally just moving units over. Because of the merger with Barclays, what BlackRock is talking about doing now is crossing individual bonds in what has become a $10 trillion system. It is the same concept; however, bonds do not trade often. BlackRock has to go out to the market and get three competitive bids and offers for every security to make sure the price is fair. The fair market price to cross (at the midpoint) makes sure that both the selling side and the buying side will win. BlackRock only does this as an agent exclusively for its clients on Aladdin. Any Wall Street firm that does this is not doing it as an agent but doing it as a principal. Fiduciaries are not allowed to engage in any principal activity.

MS. CHRISTMAN gave a brief report on BlackRock's passive equity index funds, in which they have $1.4 trillion in assets under management. They have seen a reduction in home equity bias and a movement into the broader investable market indices (IMI). There is also a growing interest in alternatively weighted strategies.

MS. CHRISTMAN reviewed the portfolio management of BlackRock's Americas Index Equity. They have detailed knowledge of the index providers in terms of benchmarking and use that information to build the portfolios. That leads to efficient trading. Lastly, they have robust systems for performance oversight and review. Scale is important in indexing in both equities and fixed income. They use all sources to keep the tracking error small.

CHAIR SCHUBERT thanked Ms. Christman and Mr. Barr for their presentation.

10. UBS Agrivest LLC

JAMES B. MCCANDLESS, head of Global Real Estate - Farmland, joined the meeting to report on the farmland economy and the ARMB's portfolio with UBS Agrivest. *[A copy of the slides is on file at the ARMB office.]* He began with a brief overview of the firm and then discussed the U.S. farm economy. While there was a sharp uptick in net farm income starting in 2002 and peaking last year, the U.S. Department of Agriculture forecasts about a 3% decline in 2012 from that high. Even with that decline, net farm income will still be the second highest on record and is expected to move back toward the trend going forward.

MR. MCCANDLESS said farmland markets in the past few years have been characterized by very low turnover and very few attractive offerings. With the income as strong as it is, no one is motivated to sell a farm. Even retired or absentee owners have no desire to sell because there are no attractive places to invest the proceeds. The dominant group of buyers in the farmland market has been, and will probably continue to be, farmers. They are flush with cash and are expanding their land holdings whenever there is an opportunity. Almost all the transactions are cash. With more buyers than sellers, it puts upward pressure on farmland prices, but the earnings tend to support these prices.

Regarding whether there is a bubble in farmland pricing today, MR. MCCANDLESS said not in all regions across the U.S. That question mostly has to do with Corn Belt pricing. UBS Agrivest has not been active in that market for several years because they have not liked the high prices there. Rents have been increasing, and UBS Agrivest has increased the rents on properties that they bought in the Corn Belt some years ago. They have converted those to flex leases, where they have been able to get closer to 4% yields last year because of the high prices for corn and soybeans. Debt has been declining in farmland, there is no evidence of speculators flipping farms, most pricing is supported by the earnings, and most buyers are knowledgeable — so he would not say there is a bubble.

MR. MCCANDLESS reviewed the ARMB's "Midnight Sun" farmland portfolio, as of March 31. The portfolio holds 65 farms in 13 states. Those farms cost $313.8 million to buy, and at 3/31/12 they were worth $397.2 million. Since inception, the ARMB has received an additional $62.4 million in distributions, of which approximately $50 million has been income and the balance capital gains and a small return of capital on properties that have been sold. He described the diversification by region and crop types, and the constraints on UBS Agrivest given by the ARMB's investment policies and guidelines. The firm has about $41.6 million in capital yet to deploy under the current allocation.

MR. MCCANDLESS reported that for all periods the Midnight Sun portfolio performance has been well in excess of the 5% total real rate-of-return over rolling five-year periods objective. The income return objective for the portfolio is to produce 4% returns over a rolling five-year period with a minimum of 3% distributed income for individual properties after fees and projected capital expenditures. For all periods since inception of the account in 2005, the cash distributions have been in excess of that income return objective.

MR. O'LEARY asked if UBS Agrivest was open for new business, and if it bothered them that some massive funds have indicated that they are going to move into farmland investments.

MR. MCCANDLESS observed that there is a lot of talk from the large funds but little action. UBS Agrivest is open for business: they also manage an open-end infinite life private REIT. That fund and the ARMB's separate account are the two accounts that they are funding currently. They also received an additional mandate for a separate account from the Iowa Public Employees' Retirement System, but they have not begun to call down any funds for that. They have notified Iowa that they will only be feeding the two current accounts while the supply of properties is so limited, or until such time as they have completed deploying the ARMB's $41.6 million remaining allocation.

MR. MCCANDLESS said they are frequently approached by large funds, and he tells them the truth that if this market stays the way it is it will be a while before UBS can deploy any capital for them. There is a significant queue of $147 million for the private REIT; however, two weeks ago they received another subscription for that. UBS Agrivest will take the subscriptions as long as people realize that it might be a while before their funds are deployed. UBS will not lower its standards in order to put money out.

MR. O'LEARY asked about the meaning and impact of the change in federal government insurance policies. MR. MCCANDLESS replied that everyone knows that the direct subsidies for the commodity program will be eliminated and substituted by a more robust crop insurance program, which will act as a safety net for disasters. Those premiums are subsidized to a handsome degree. Probably the biggest beneficiaries of that policy change are the companies that sell the insurance.

At MR. BADER's request, MR. MCCANDLESS provided a brief description of the rotation process for allocating a property that becomes available to purchase. He noted that the ARMB's guidelines for new acquisitions carry a higher current return requirement (5%) than UBS Agrivest's farmland fund does. As a result, if the current return projection for a new property is below 5%, it does not fit the ARMB and would go to the farmland fund. However, the ARMB would remain up for the next available property, etc.

MR. WILSON remarked that there is a time to be sellers in any asset class. He asked what the Board should be watching for as a time to exit — the usual tip-off is when there are more buyers than sellers, and it sounded like there were a lot more buyers for farmland than there were sellers.

MR. MCCANDLESS stated that UBS Agrivest does a hold/sell analysis on every property every year to determine whether they should sell the property. They have identified some properties for sale that are under contract right now. They would not recommend that the ARMB sell out its portfolio because they think the fundamentals for the farmland economy are quite good going forward. All the reasons that the ARMB is in farmland — inflation hedging, diversification, solid income returns, and a fairly steady, predictable trend of return history — are holding true. UBS Agrivest does not see any kind of looming collapse of this market; like everyone else who owns farms, they like farmland and believe it is time to continue holding onto them.

MR. JOHNSON mentioned that some states, particularly in the Midwest, have provisions that prevent sales of farms to institutions or corporations. He asked if any of those laws were likely to change such that land would be freed up and have an effect on the farmland market.

MR. MCCANDLESS said Nebraska had a law that was struck down on the commerce clause provision and opened up the state about three years ago. The other states with similar prohibitions are Iowa, North Dakota, South Dakota, Minnesota, Missouri, Kansas, and Oklahoma. Someone would have to bring lawsuits in those states, similar to what happened in Nebraska. UBS Agrivest looked around in Nebraska, but the state sort of suffers from the Corn Belt syndrome with high prices there. However, it depends on the circumstances, and UBS Agrivest may find some property there that will fit. Turnover in Nebraska is similar to all the other states.

CHAIR SCHUBERT thanked Mr. McCandless for his presentation.

11. Actuarial Review

11(a). Level Dollar Assumption Resolution 2012-19

Earlier, MR. PIHL had distributed copies of a draft resolution supporting adoption of a level dollar amortization method for amortizing the unfunded accrued actuarial liability of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) over 25 years *[draft resolution on file at the ARMB office]*. He spent a few minutes going through the clauses of the resolution for the benefit of the other trustees. He emphasized that more than $2 billion in contribution requirements could be saved through use of the level dollar approach. He noted that the level percentage of pay method was part of a legislative package the Board was given, and, at the time, the Board was pleased that there was a plan to retire the unfunded liability over 25 years.

MR. PIHL mentioned that the resolution's effective date on contributions is delayed to fiscal year 2015, since later at this meeting the Board would be setting the contribution rates for fiscal year 2014 based on the June 30, 2011 actuarial valuations, and Buck and GRS certifications based on the level dollar method could not be completed before this meeting.

MR. PIHL said he strongly believed that the level dollar method was the right course for the ARMB as fiduciaries, for the State itself, and for all participating employers across the state. He said the Board fully recognized that in the end State contributions are determined by the budget and appropriation process, and the resolution would set a more fiduciary and fiscally sound course.

MR. BARNHILL clarified that Buck did complete the work regarding level dollar for the FY11 valuation, and it was presented to the Board at the last meeting. MR. PIHL acknowledged that, and noted that the GRS certification was not possible before this meeting.

COMMISSIONER HULTBERG shared information on the Governor's most recent thoughts, to help in the Board's discussion about whether now is the best time to move to level dollar. The Governor had made a comment earlier in the legislative session that he was leaning toward level dollar and supported the concept of level dollar. She said it is important to reiterate the Governor's overall commitment to the pension system, to meeting the constitutional obligation to pay benefits, to paying down the unfunded liability, to maintaining the health of the funds, and to managing the costs over time so that the State can meet its other constitutional obligations. Since he made the statement that he was leaning toward the level dollar method, the Governor has become concerned about some recent events. The first is the uncertainty in the global financial markets, and specifically with respect to Europe. There is concern over what the near-term and the longer-term prospects are for significant recovery. The second is the recent decline and volatility in the price of oil. The FY13 budget was built on $104/barrel oil, and today's North Slope crude closed under $93/barrel. Oil could go back up, but right now the price is significantly lower than the budget breakeven point. Along with the price of oil, there is the continued decline in oil production, which is again a concern about General Fund flexibility.

COMMISSIONER HULTBERG said the Governor expects and understands that the ARM Board will exercise its best professional judgment in making this decision, and he respects the Board's role in doing that. In the Governor's role he has other considerations as well, and he, too, will be exercising his professional judgment.

MR. TRIVETTE stated that he talked to actuaries from both GRS and Buck at a conference last fall. The question was put to them directly about which way to go with a closed retirement fund: they both suggested a level dollar method.

MS. ERCHINGER said the resolution was one meaningful step the Board could make. An earlier presentation mentioned that on average 60% of funding for the retirement plan comes from investment earnings. It struck her that the longer the delay in putting contributions into the system, the less there will be available upon which to make the investment earnings. It is just putting the problem off onto future generations of Alaskans. She recognized that was hard for the people who have to balance the state's budget, but it would get harder, not easier, if people do not do what they can do today to help make it easier tomorrow. That was why she was going to support the resolution. She recognized that there was more work to be done, and she hoped that the Board would continue to dialogue with members of the legislature and the state administration going forward.

COMMISSIONER BUTCHER stated that, as a concept, he understood the benefits of the level dollar method. He was concerned, considering what is going on globally, and with Alaska's oil production and the price of oil, and it was a struggle for him to try to determine the direction to go on the resolution. He related hearing the views of a couple of legislators the day before, and they and the Board seem to be on completely different sides of the unfunded pension liability. Regardless of which direction it goes, there are benefits and difficulties to deal with on each side, and it makes it hard to decide.

MS. HARBO spoke in support of the resolution. She recalled that in 2006 the Teachers' System paid in at a level dollar amount for a short period, and that was because the two actuaries at the time were talking about a closed system. Then the legislature put the employer contribution rates into statute, and things went to the level percentage of pay method. She thought the Board needed a bit more information at the time about how the different methodologies would affect the money that was going in. If the Board had done what it did when it set contribution rates in 2006, she believed there would be a much lower unfunded liability right now.

Presenting her view as a trustee, COMMISSIONER HULTBERG said she would not support the resolution, although she understood and respected why many of the trustees likely would support it. She believed that over time pension funding has to coexist with public needs. It is to the detriment of the pension fund if that balance gets tipped. When that balance has tipped too far in other states, taxpayers have reacted against the pension funds. She did not want so much pressure on the General Fund that it reached that tipping point. The problem is a generational problem, and everyone has to find a way for the pension funds to coexist with the needs of the public for several decades potentially into the future. That is what she would be voting on, and she believed that level percent of pay at this time was the best way for those public needs and pension funding to happily coexist. When the context changes, what is the right approach for this time may not still be the right approach next year or the year after or the year after. The dialogue is important and needs to continue, and it is a question that will be revisited potentially many times in the future.

MS. ERCHINGER asked board counsel if the Board could take this action, saying there have been questions in the past because legislation established the amortization methodology based on the level percentage of pay method.

MR. JOHNSON replied that there has been discussion on the subject, and he has spoken with assistant attorney general Chris Poag, who did a fair bit of research on it. *[He tried to raise Mr. Poag on the teleconference connection but got no response.]* He said the assistant AG's analysis is that nothing under SB 141 would preclude the choice of different amortization methodologies. There was discussion in the passage of SB 125 more recently, but there does not appear to be either in the literal language of the statute or within any reasonable pieces of legislative history any indicators of an actual prohibition from the Board adopting the level dollar method of amortization. The Board's choices of doing that falling within the fiduciary standards and so on should be filled out, as best as possible, with the history and a clear paper trail of discussion on how the Board came to a conclusion. That was even brought up yesterday in the Audit Committee meeting, where the KPMG auditors, who are charged in some respects with looking at some of the actuarial figures, made note of the point that they would look at history and analysis and conclusions and the basis for all of that. From a statutory perspective, it is within the Board's parameters to do this and act wisely.

MR. TRIVETTE remarked that the Board has been discussing this for years, and it has heard lots of people talk about it. He has received dozens of emails and phone calls, and none have indicated that they would support anything other than the level dollar method. It is a big issue with many retirees, and he appreciated the commissioner meeting with a group of retirees yesterday. He said he has told retirees that part of the actuary process is that any unfunded liability will get 8% of that added onto the bill, so to speak, for the next year. For the most recent actuarial report from Buck Consultants in April, that is $1.474 billion. That is pretty telling. In spite of having good investment returns in recent years, the pension system is still going into the hole. The $1.474 billion being added to the unfunded liability is certainly part of the reason. This was why he thought it important to consider changing the amortization method back to what it was when this Board took over in 2006.

MS. HARBO said one of the most compelling reasons to vote for the resolution was that using the level dollar amortization method would reduce the total amortization payment by $2.4 billion over time. If the level dollar method had been used since 2006, the savings would have been even greater.

MR. PIHL explained that the resolution set the course for actuarial work to be done, but everyone realizes that the ARMB does not make up the state budget and does not appropriate funds. To the extent that there may be limitations, the ARMB would be living with them down the road. He did not think it was wise public policy to backload, costing billions of dollars more. The constitution says that the resources of Alaska are to be used for the benefit of all of the people of Alaska. The management of resources should occur to address the [pension] liability and minimize the cost as much as possible.

CHAIR SCHUBERT said she completely supported the concept of the proposal, and she appreciated Mr. Pihl's passion for getting this issue resolved and all the work he had done. The country has been experiencing an unusual financial situation in the past several years. If the Board could do something like the resolution and be assured that things would continue to progress and the country would not go into a double-dip recession, that markets would not crash again, that the price of oil would stay up, and all the other things that are looming out there would not become a reality, she would feel a lot less concerned about the proposed change. However, she was wondering if the timing was right. The lower price of oil is good for commuters, but it is not so good for the state's budget. The state's resources are to be used for the benefit of all of the people of Alaska. The unfunded [pension] liability basically benefits a closed class of people and not all of the people of Alaska. If there are things in the budget that are cut out because the unfunded liability has to be managed and met, it is to the detriment of people from rural Alaska, for example, or some of the other parts of Alaska that maybe do not have the clout to bring the bucks home like some folks do.

CHAIR SCHUBERT said she had a real concern about whether this was the right time to take the proposed action. She was concerned that it not break the backs of some of the municipalities and the people responsible for making the increased [contribution] payments if things fall apart again. Moodys just downgraded some financial institutions a couple of hours ago. There are other things happening that make her uneasy about financial stability and the look forward. The State of Alaska is one of the most aggressive states in terms of addressing the unfunded [pension] liability issue and has done a tremendous job. Other states do not seem to be doing much of anything. Alaska's is an unfunded liability that is not going to come due tomorrow or the day after. It is a future obligation that will have to be met; that much is clear. She was not comfortable with making a change right now, and it was mainly because she was not comfortable with what is happening in the financial markets.

MR. PIHL listed the alternatives: (1) stay on the current course, in which case state assistance will soon grow to $1.1 billion a year; or (2) something like the Senate Bill 187 proposal, extending the amortization period and shifting more cost to the municipalities. He did not believe there was any appetite in the legislature for number 2.

MR. BARNHILL reported that Mr. Poag was listening by telephone, but the connection was apparently muted and he could not be heard.

MR. PIHL moved that the Alaska Retirement Management Board adopt Resolution 2012-19, relating to a level dollar amortization assumption for the Public Employees' Retirement System and the Teachers' Retirement System. MS. HARBO seconded.

Roll call vote:
Ayes: Erchinger, Harbo, Pihl, Trivette
Nays: Butcher, Hultberg, Schubert

The motion carried, 4-3.

The Chair called a scheduled break from 3:11 p.m. to 3:22 p.m.

11(b). Final GRS Certification of Actuarial Valuation - FY11 PERS/TRS/JRS/NGNMRS

MR. BADER stated that Gabriel Roeder Smith & Company made a presentation at the April meeting on their review of the valuation reports that Buck Consultants prepared for the PERS, TRS, and the Defined Contribution Retirement Plan as of June 30, 2011, and the roll-forward valuations for the Judicial Retirement System and the National Guard Naval Militia Retirement System as of June 30, 2011. He asked that the Board entertain a motion to accept the final GRS certification.

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

MR. TRIVETTE noted that there were minor changes in the final report that were not significant, and both reports totally supported the recommendation.

MR. BARNHILL stated that discussions regarding the GRS report have been underway in the division since it came out.

The motion carried unanimously, 7-0.

11(c). Final Actuarial Valuation - FY11, PERS/TRS/NGNMRS

MR. SLISHINSKY of Buck Consultants, Inc. offered to answer any questions on the April presentation that he made on the actuarial valuation results as of June 30, 2011, as the Board considered the contribution rates for fiscal year 2014.

MR. TRIVETTE moved that the Alaska Retirement Management Board accept the actuarial valuation reports prepared by Buck Consultants for the Public Employees', Teachers', Public Employees' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits) and Teachers' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits) retirement systems as of June 30, 2011, in order to set the actuarially determined contribution rates attributable to employers. MS. HARBO seconded.

The motion passed unanimously, 7-0.

MS. HARBO 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, 2011, in order to set the actuarially determined contribution amount. MR. PIHL seconded.

12. Contribution Rates for FY2014

MR. PUCKETT handed out a single-page chart entitled "History of PERS/TRS Employer Contribution Rates" for the years FY09 to FY14 *[on file at the ARMB office]*.

MS. HARBO indicated she would like the chart in the future to include the FY08 contribution rates.

MR. BARNHILL stated that the proposed employer contribution rate for PERS for FY14 was 35.68%.

MR. PIHL moved that the Alaska Retirement Management Board set fiscal year 2014 PERS actuarially determined contribution rates attributable to employers consistent with its fiduciary duty, as set forth in the attached form of Resolution 2012-10. MR. TRIVETTE seconded. The motion passed unanimously, 7-0.

MR. PIHL praised the Department of Administration for leading the reduction in health care costs that has benefitted the retirement system.

MS. HARBO moved that the Alaska Retirement Management Board set the fiscal year 2014 Public Employees' Defined Contribution Retirement Plan Retiree Major Medical Insurance rate as set out in Resolution 2012-11. MR. PIHL seconded. The motion passed unanimously, 7-0.

MR. BARNHILL said the rate remained unchanged at 0.48%.

MR. TRIVETTE moved that the Alaska Retirement Management Board set the fiscal year 2014 Public Employees' Defined Contribution Retirement Plan Occupational Death & Disability Benefit rates as set out in Resolution 2012-12. MS. HARBO seconded.

MR. BARNHILL said the recommended rate for PERS peace officer/firefighter OD&D was set at 1.14%, and the recommended rate for PERS "all other" OD&D was set at 0.20%. The motion passed unanimously, 7-0.

MR. BARNHILL stated that the recommended rate for the TRS Defined Benefit Plan for FY14 was 53.62%.

MS. HARBO moved that the Alaska Retirement Management Board set fiscal year 2014 TRS actuarially determined contribution rates attributable to employers consistent with its fiduciary duty, as set out in Resolution 2012-13. MR. TRIVETTE seconded. The motion passed unanimously, 7-0.

MR. BARNHILL stated that the FY14 recommended rate for the TRS Retiree Medical for the Defined Contribution Plan decreased slightly to 0.47%.

MS. HARBO moved that the Alaska Retirement Management Board set the fiscal year 2014 Teachers' Defined Contribution Retirement Plan Retiree Major Medical Insurance rate as set out in Resolution 2012-14. COMMISSIONER HULTBERG seconded. The motion passed unanimously, 7-0.

MR. BARNHILL said Buck recommended no change to the TRS DCR Occupational Death and Disability Benefit and that the rate remain 0.00%.

MS. HARBO moved that the Alaska Retirement Management Board set the fiscal year 2014 Teachers' Defined Contribution Retirement Plan Occupational Death & Disability

Benefit rate as set out in Resolution 2012-15. MS. ERCHINGER seconded. The motion passed unanimously, 7-0.

MR. BARNHILL stated that the recommendation for the military plan is a dollar figure, and Buck recommended $474,791 for FY14.

MR. TRIVETTE moved that the Alaska Retirement Management Board set the fiscal year 2014 NGNMRS annual actuarially determined contribution amount consistent with its fiduciary duty, as set forth in Resolution 2012-16. COMMISSIONER BUTCHER seconded. The motion passed unanimously, 7-0.

MR. BARNHILL mentioned that the Judicial Retirement System (JRS) rates for FY14 are the product of a roll-forward actuarial letter that Buck Consultant does for the commissioner of administration. By statute, these rates and acceptance of the valuation are within the commissioner's purview. In this case, Buck recommended an increase in the JRS employer contribution rate to 73.28%. The commissioner has approved that.

13. Health Care Plan Update

Deputy Commissioner MIKE BARNHILL and DRB Director JIM PUCKETT made a presentation on the retirement health plans *[the slides are on file at the ARMB office]*. MR. BARNHILL stated that the spending on health care for PERS, TRS and JRS has more than doubled from 2001 to 2011. As of the FY11 valuation, about $4.1 billion of the $11.1 billion unfunded liability was related to health care. He added that the Division of Retirement & Benefits (DRB) has 14-15 staff to manage claims, counseling and eligibility, and they do not have the capacity to become more proactive and more strategic in managing the health care side of the pension systems. The commissioner and himself and Mr. Puckett spend a lot of time talking about how to become more proactive in managing the health care side of the equation.

MR. BARNHILL reviewed some statistics on retiree medical expense growth and the change in health care utilization. He offered examples of physician fees for certain medical procedures in the Washington area and the Anchorage area *[slide 4]*.

COMMISSIONER HULTBERG stated that it is to everyone's benefit to have a healthy medical system in the state. But it is undeniable that the state cannot continue to see the cost trends and cost increases that have been experienced. As health plans have to grapple with 8-9% cost escalation in a year, the state has to explore all viable options for lowering the rate of growth. Sending people out of state for care is one of the alternatives that is being actively explored. There is no one quick fix to this, and Alaska is one player in the midst of a system that is broken nationally and is particularly dysfunctional in this state. As an employer, the state can play a role in trying to work with the provider community to express its concerns and to see what can be done to lower the growth rate of health care costs. At the end of the day, 8-9% growth in costs is not sustainable.

MR. BARNHILL stated that there is no incentive for retirees to stay in network, and between 40% and 50% of plan spending is out of network.

COMMISSIONER HULTBERG explained that what is driving the bulk of the cost is the pre-Medicare population between the ages of 50 and 65, because, once people get to Medicare age, AlaskaCare is secondary.

MS. HARBO recalled that a Health Care Committee in the 2003-2004 time frame recommended that the retirement systems should not work in isolation, and that there should be something like a health care summit for the whole state of Alaska so people get together to talk about how they can reduce costs. She still thought that was a good idea.

COMMISSIONER HULTBERG assured Ms. Harbo that the state is actively engaged with the Health Care Commission because it is a good forum for these conversations to occur. She said she had spoken to the State Hospital & Nursing Home Association, and planned to speak to the Providence Hospital board in July.

MR. BARNHILL reviewed statistics on the prevalence of chronic diseases in the active member and retiree populations for a two-year period 2010-2012.

MR. BARNHILL also explained in detail the near-term objectives for the DOA/DRB health plans:

- Issue an RFP for a third party administrator (TPA) on 8/15/2012 and have the process completed by the end of the year. A six-month transition from one TPA to another would begin on January 1, 2013. This time, issue simultaneous RFPs to independently contract for a care manager and a pharmacy benefit manager.
- Create and implement a health plan for the Defined Contribution Retirement System.
- Create an "Option B" health plan for the Defined Benefit Plan.
- Align coverage across the various health plans that DRB administers.
- Investigate and implement innovations to reduce the cost and improve the quality in all the health plans.

MR. BARNHILL presented a side-by-side chart of the features of the existing retiree healthcare plan for the Defined Benefit Retirement Plan and the proposed healthcare plan for the Defined Contribution Retirement Plan *[slide 10]*. He said the department intended to take the proposal on the road this summer to present to a variety of stakeholder groups for input and comment. The goal is to provide comprehensive health coverage in a sustainable 80/20 shared cost, and to get the health reimbursement account (HRA) to last as long as possible.

MS. RODELL asked when the first retirees were expected to roll into the DCR retiree health plan. MR. BARNHILL said a handful of members will be eligible in three to four years. He added that it is incumbent upon the department to get the health plan set up so the members approaching retirement will know what benefit they are working toward.

CHAIR SCHUBERT raised the idea of assigning this topic to a health care committee. MR. JOHNSON mentioned that such a committee already existed. MR. TRIVETTE remarked that the committee's charter had a single focus of health care cost containment, so he thought the charter would have to be amended to broaden the scope of a reconstituted health care focused committee. MS. HALL said she would double-check the existing charter.

MR. BARNHILL recalled discussing something with Mr. Johnson in 2007, and he agreed with Mr. Trivette's statement that by statute the ARMB does not have any identifiable role with respect to administering the health plan. However, by statute the ARMB is authorized to advise the plan administrator on plan administration. In that respect, the ARMB can establish such a committee to provide that consultation and advice, and it would be completely consistent with the statute.

CHAIR SCHUBERT suggested creating the Health Plan Advisory Committee and doing away with the prior committee.

COMMISSIONER HULTBERG made it clear that the health plan administrator was asking for the Board's advice.

CHAIR SCHUBERT solicited interest from Ms. Harbo, Mr. Trivette and Commissioner Hultberg to serve on the committee. She agreed with Ms. Harbo's suggestion to include one of the new unnamed trustees as well.

MR. BARNHILL stated that almost all large employers are struggling with how to become proactive in managing health care spent to innovate. The Department of Administration has been thinking of it on the demand (member) side and the supply (provider) side. On the member side, they have been looking at wellness programs, preventive care, incentives, and enhanced travel. On the provider side, the ideas being considered are an enhanced network, cost negotiations, and enhanced travel. The idea is to roll out these innovations, measure the results, and take what works and expand it across the populations. The department asked the Office of Management and Budget to add a position to the Division of Retirement & Benefits that would help coordinate some of these initiatives. That position was approved, and the person begins work on Monday. The department is excited about getting more capacity within DRB to begin thinking strategically about how to be more proactive in managing the spending, while expanding health care options and hopefully improving outcomes.

MS. ERCHINGER asked if the proposed new DCR health plan would remain in place, regardless of what happens with the federal Affordable Care Act. MR. BARNHILL replied that there was a lot of discussion across the country about what happens if the Supreme Court strikes down the Affordable Care Act. The most recent article he read suggested that many large insurers are planning to simply just keep some of the provisions in place.

He said the key is to have a plan that pays for itself and is sustainable over time.

RECESS

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

Friday, June 22, 2012

CALL BACK TO ORDER

CHAIR SCHUBERT reconvened the meeting at 9:02 a.m. Trustees Schubert, Trivette, Harbo, Erchinger, Pihl and Butcher were present. Commissioner Hultberg joined the meeting at 9:45 a.m.

REPORTS (Continued)

14. Eaton Vance Management

Relationship manager KRISTIN GASPAR and portfolio manager BRIAN DILLON joined the meeting to provide an update on the emerging markets fund that Eaton Vance partner Parametric Portfolio Associates manages for the ARMB. *[A copy of the presentation slides is on file at the ARMB office.]*

MS. GASPAR briefly reviewed the Eaton Vance firm, informing the Board that they announced yesterday that they were going into an agreement to try and acquire 49% of Hexavest, Inc., an asset management firm based in Montreal. Hexavest's expertise is in fundamental, global and international equity management with $10 billion in assets under management.

MS. GASPAR stated that Parametric has become a big piece of Eaton Vance's business since the partnership began in 2003, managing $48 billion in assets under management. Eaton Vance now has a majority interest in Parametric.

MR. DILLON said Parametric manages almost $13 billion in total emerging markets assets. In the specific strategy that they manage for the ARMB they currently have a little over $10 billion. In the institutional segment, they have seen a lot of growth within their structured active portfolios. These are quantitative, rules-based strategies that are engineered to be a core holding in a given asset class.

The three ideas that drive their investment process are to reduce concentration risk that builds up in different indices, to reduce volatility in order to amplify compounding long-term returns, and to develop a rebalancing strategy that will allow them to extract a premium from the volatility in an asset class and actually profit from it. MR. DILLON said Parametric has been able to apply that approach not only in emerging markets but also in commodities, international equities, and currencies.

MR. DILLON spent a few minutes explaining how they see the emerging markets in the world and how they design and engineer their investment process around the specific characteristics of an asset class. It is a very risky marketplace with high volatility, but it also has a low level or correlation - so what happens in China does not dictate what is happening in Peru, or vice versa. They also see quite poor information coming out of emerging markets on which to make informed decisions. Transaction costs remain significantly high, especially in the smaller countries.

MR. DILLON stated that Parametric has found that some smaller emerging market countries actually have lower volatility than the larger markets. They are able to reduce the overall volatility of the portfolio by infusing some of the smaller countries in the mix, but doing that in a way that they are not taking on too much liquidity risk. They also find that they have lower levels of correlation specifically once they move down the stratus from a country perspective. They assign countries to tiers based upon market capitalization and liquidity. The largest, most liquid countries are in tier I, and the smaller, less liquid countries work their way down into tiers II, III and IV. They use a modified, equal-weighted approach so they are not taking a view on any of the countries, but they are simply building an exposure vehicle to do this in a risk-controlled way.

They also look at country specific risk from a tracking error perspective and have a set of rules in place that if that risk grows too much they can reduce it. Given that the big bets in the portfolio are underweights to large countries, they have to increase the exposure to reduce relative risk. They try to achieve a very disciplined and consistent exposure across all the countries, assuming that liquidity stays constant and assuming that market cap stays constant.

MR. DILLON said they then use this model similar to how one would think about an asset allocation mix, and they rebalance back to the static weights in order to capture returns along the way. He stressed that Parametric approaches the world from a very different perspective than many of the ARMB's other asset managers. They do not have a view, and they are not making calls on moving in or out of a country based upon different economic factors or things like that.

MR. TRIVETTE remarked that Parametric did not have a big staff but had done exceptionally well, so he wondered how they deal with getting good data from the smaller countries.

MR. DILLON said they try to be very agnostic to the data itself. They cast the net as far and wide as they can: anything that is not considered developed they consider to be emerging. That is why they include the frontier markets. They use a universe of countries and then below that securities that are driven by a few products that S&P puts out. As they build the portfolio, the main driver of their returns is their country selection process (the tiering mechanism) in combination with their rebalancing. Eighty percent to 85% of their return attribution over the last ten-plus years has been driven by those two things working in concert. They try to make their decisions without having to rely on the data. So when they gain exposure to individual securities, they are simply using those securities as exposure vehicles to a country and exposure vehicles to a sector, and then maintaining a highly diversified portfolio. The ARMB's portfolio is in a fund that is invested across nearly 1,500 securities; if an individual security runs into a problem, it will have such a small allocation in the portfolio that they can absorb that. It is safety in numbers.

MR. WILSON noted that Parametric is invested in some countries that not many people are in, such as Kenya, and Parametric's product has grown a lot. He asked how much capacity there is in these countries, and if Parametric runs up against the capacity issue.

MR. DILLON responded that they look at capacity on an ongoing basis. Given their quantitative, rules-based approach, they can actually back into a number as they put a whole set of constraints in place and then apply that based upon the liquidity of the underlying securities. They calculate that on a semi-annual basis. In their flagship product structured emerging markets they have about $10 billion in assets, and they estimate right now that they could probably manage somewhere in the $15-$18 billion in assets. They maintain very small disciplined exposures, so a maximum of roughly 75 basis points in a lot of these countries. What drives the amount of money they can deploy is the number of securities that are available for investment in those specific countries and the liquidity and in those securities. They invest as much they can in a security without starting to influence liquidity or ownership in that company.

MS. RODELL asked how Parametric looked at political risks, such as nationalization in Argentina. MR. DILLON replied that they focus first and foremost on shareholder protections, so nationalization is something that gets their attention. Geopolitical risk or political power coming in or out are things that they do not get hung up on. When they are adding or removing a country from the portfolio they look first at shareholder protections, such as a proper rule of law. They then look at such things as market cap, liquidity, are there sufficient broker/dealers to work with, and can they custody assets. The only piece of fundamental analysis they look at is the P/E of the overall country when they first invest to make sure they are not buying into a bubble. Once a country is included into their model, then the rebalancing mechanism will take any froth off the top. Another piece they look at is put out by the Heritage Foundation, which rates countries around the globe based upon degrees of economic freedom.

MR. JOHNSON mentioned a growing interest on the part of pension funds to make sure that they have proper legal representation in cases that might arise in foreign countries. He asked if Parametric engaged in any active consideration of legal rights and remedies that one might have if an emerging market company blows up.

MR. DILLON stated that traditionally they rely mainly on the custodial banks for that information. Also, one of the reasons that Parametric partners with Eaton Vance is that Eaton Vance has a legal team that works on some of those types of issues. However, when Parametric is going to invest in a country, they look at whether the rule of law as it is explained is going to provide the shareholders with enough protection that they can say they can invest in the country. But being in the local countries doing ongoing investigation in their court systems, etc. is not part of their process.

MR. BADER asked to what degree Parametric looked at sectors and tried to balance them either across the whole mandate or within a country. MR. DILLON said their process is a very top-down approach that starts at getting the country right. They use a proprietary portfolio management system to deploy the percentage of the portfolio allocated to a tier. It allows them to build the portfolio country by country, and within a country they are going to build it sector by sector. Their model is simultaneously solving to get to as equal-weighted as possible, taking the constraints into account. When building the portfolio is when they look at the liquidity of the underlying securities.

MR. O'LEARY said there was news this week of the possibility that Greece would be thrown out of the developed market index and become part of the emerging market index. He asked how long it would take Parametric to implement Greece as part of this product, if that were to happen.

MR. DILLON replied that significant changes take place in the index weights over time. Anything that is not considered developed they would consider as a possible investment. So if the index providers moved Greece down into emerging status, that would put it in Parametric's universe of possible investments. That does not necessarily ensure that they would invest in Greece; it just means that it is possible. Israel is the most recent graduate up, and Parametric will remove it because it is no longer in their universe.

MR. O'LEARY said one of the concerns that all investors should have had over the last couple of weeks is the ability of subcustodians to continue to function in Greece. He asked how Parametric would think about that and decide there was or was not enough safety to begin to invest in a market like Greece at this time.

MR. DILLON explained that part of their process of looking at countries is looking at custodial relationships and subcustodians, and if there is sufficient coverage to actually physically implement. Across the various vehicles that Parametric manages in separate accounts for large institutional clients in the U.S. and overseas they work with most of the very large institutional custodians. Part of the process is to check in with all those custodians they work with and make sure that at the local level they are able to implement.

MR. BADER stated that when the Board first gave this mandate to Eaton Vance, it was in a collective trust. When it was decided to divide the pension funds into health trusts and pension trusts, the collective trust did not meet SEC requirements for a health trust to invest in. Out of necessity, assets were transferred from the collective trust to the mutual fund. It was a rough patch in the market when the transfer took place, and there was a hit to performance. There was some manager underperformance, but a lot of it was due to stepping from one investment vehicle to another. He advised that trustees focus primarily on the three-year performance, because the long-term history is muddied because of the transition from the collective trust into the mutual fund.

Addressing performance, MR. DILLON said that year to date the emerging markets index has been essentially flat, having given back a lot of the big run-up in the first part of the year. Parametric has been able to outperform very nicely, and the Structured Emerging Markets Fund is up 165 basis points versus the index's seven basis points. Parametric has been able to provide down-side protection through its very transparent process. The main drivers of performance so far this year have been the underweight to Brazil, and the returns from Kenya, Qatar, Kuwait and Nigeria. An underweight to Taiwan has hurt performance so far this year, and some of the Eastern European countries have hurt as well. That does not cause Parametric to change the portfolio, but they were simply reporting how things have played out during a specific period of time. Their three-year return was a strong number, and the main driver there has been China and Brazil over the last year. Countries like Egypt and Kuwait over a three-year period have hurt returns.

CHAIR SCHUBERT thanked the people from Eaton Vance for their report.

15. Hancock Agricultural Investment Group (HAIG)

Firm president OLIVER WILLIAMS introduced PAUL JOERGER, who joined HAIG in May as director of asset management. *[A copy of the HAIG slides is on file at the ARMB office.]* MR. WILLIAMS gave an update on the firm first, bringing to attention that last year they broke out Research as a discrete function and hired Dr. Cody Dahl to lead that effort. He said the ARMB's account was established in January 2005, and the current allocation sits at $245.25 million. To date, they have committed $214 million and still have $31 million available for investment. The properties in the account are owned and operated through a series of six LLC entities.

MR. WILLIAMS said the market value of the farmland portfolio at March 31, 2012 was $240 million. It is well diversified across the U.S.; 27 properties in total are invested in 11 states. The portfolio has fairly equal weightings to the Corn Belt, the Delta, the Southern Plains, the Mountain States, and the Pacific West. The heaviest weightings by commodity group are corn, soybeans, and wine grapes. Eighty-one percent is invested in row crops and 19% in permanent crops.

MR. WILLIAMS reported that the ARMB's portfolio underperformed relative to the index in the most recent year, which reflected the termination of a lease on a vineyard asset called Sonoma 12 in January that came with a fairly good premium for termination. HAIG is currently working with a local vineyard specialist in California to reposition that asset. The wine industry has had a relatively fixed production base for the last 10 years, and there has not been a lot of catalysts moving wine grape prices up. HAIG saw demand for wine grapes go up over the last 12 months, and now demand has outstripped supply. They are confident that the industry is headed in the right direction for them to find a suitable lease for the vineyard property.

The row crop portion of the portfolio produced a 4.5% income return in the last year, which is better than the index. The near-term performance is weak, but once they resolve the lease on Sonoma 12 they will see improvement there.

MR. WILLIAMS said the total portfolio return (including appreciation) was 14.86% for the year ended March 31, or 13.9% after fees. HAIG saw nice appraisal gains in the third quarter of 2011, 10.97% appreciation in total. The regions that provided the most appreciation were the Corn Belt, the Delta, the Lake States, Nebraska, and the Pacific West. Values were flat in the Southeast and the Southern Plains. Over longer periods, the portfolio is tracking relatively closely to the index.

MR. JOERGER provided more details on select properties in the ARMB portfolio. He showcased a leased row crop property in Colorado that encompasses nearly 2,000 acres and grows predominantly corn and wheat. This property has seen annualized returns of a little over 16%, which HAIG believes is very good for the current marketplace. The demand for farmland continues to increase. A second property of interest is a permanent planting of a nut orchard in California. They are ending a 10-year lease in 2014, and the rent, which has been attractive, will be renegotiated. Since inception, this property has returned a little over 13%, which is very attractive for this kind of investment.

MR. O'LEARY asked if the ARMB owns the mineral rights on its properties, if that was typical or atypical, and what the implications and protections of water accessibility were.

MR. WILLIAMS replied that in the Western U.S. most of the mineral rights have been stripped off over time. When HAIG is looking at a farm property, the majority of the time it is coming without minerals. There are a few exceptions, and, in cases where they do receive the mineral rights, occasionally they field calls from exploration companies. HAIG works through those on a case-by-case basis. They have not seen linkage between the mineral exploration and water quality or water availability. But one item they are keenly focused on during underwriting of a property deal is water quality and availability. That is done independent of the minerals.

MR. WILLIAMS stated that the ARMB portfolio was budgeted to produce a little over $8 million in net income for FY2012. They have approximately $31 million of capital available to source additional investments.

MR. O'LEARY asked for comment on HAIG's backlog of money to be invested and how they deal with that. MR. WILLIAMS replied that their queue is around $400 million available for investment. Each client has different investment objectives, but they come to the opportunity line at the same time. HAIG has a team of three that is dedicated to generating suitable acquisitions, and they look at where the best fit is among the clients. Typically, a property fits one client over another, so they rarely run into a situation where the same investment is suitable for more than one client. In instances where that happens, they run a rotating process, so the client that had signed the contract with HAIG first gets the investment first, and then it rotates to the next client. They have found that there has not been as much competition in the queue as people would expect, but it is something that they monitor closely so they do not run into issues.

MR. O'LEARY asked if HAIG made any investments outside the United States. MR. WILLIAMS said they have a platform in Australia, but the last new capital they took there was in 2005-2006. HAIG went to Canada in 2009. They have nothing in South America, although he recently took a trip to Chile, and others at HAIG have been to Brazil. So South

America is something they are studying very carefully and trying to figure out the right entry point, because they want to see a value proposition that is commensurate with what they believe the risk to be in going there.

MR. TRIVETTE inquired where HAIG expected the additional $31 million in ARMB capital might go in the next year or two. MR. WILLIAMS said the majority of it would likely go into leased row crops: if they could find a good permanent planting in the $3-$5 million range with the right income attributes, they would be interested. When considering value related to the ARMB investment guidelines, they might see something in the Pacific Northwest or in California. Right now, it is tough to make the Midwest work for new capital. They see opportunities in Idaho, the Pacific Northwest, and some possibilities in the Delta and Texas. The Board could expect them to put the money to work in the next six to twelve months.

CHAIR SCHUBERT thanked the gentlemen for their presentation.

16. IFS Action Items

MR. BADER said staff continued to review the recommendations from the December 2010 audit report by Independent Fiduciary Services and to forward staff recommendations to the Board. He expected to be done with the review process at the September meeting. *[The written staff reports are on file at the ARMB office.]*

MR. SIKES explained that the first two IFS Report recommendations have the same recommended action by the Board, which is to affirm the current investment guidelines. He reviewed the first IFS recommendation, B-1, #2, Publicly Traded Asset Classes. He said the discretion to allow equity managers to invest in certain fixed income securities with the ARMB's equity guidelines and contracts has existed for a very long time and is designed to provide flexibility for any unforeseen circumstances where market conditions may warrant alternatives to stocks. While there is no memory of an equity manager exercising this ability, the value of keeping this flexibility is considered greater than the cost of removing it. Manager contracts are clear as to the investment strategy and benchmark. Any investment by an equity manager in a fixed income security would be detected and investigated promptly by staff. So on this IFS recommendation, staff recommended that the Board affirm its existing guidelines.

<u>MS. HARBO moved that the ARMB affirm the existing Investment Guidelines for Domestic and International Equities in Resolution 2012-08</u>. <u>MR. TRIVETTE seconded</u>. The motion passed, 7-0.

MR. SIKES next reviewed IFS recommendation B-1, #3, Publicly Traded Assets Classes. He said this IFS recommendation appeared to be addressing guideline structure rather than substance. ARMB's current use of a singular equity guideline document across equity strategies, in staff's opinion, helps promote consistency across equity mandates and board-level understanding of its policies. While possibly making it easier for investment managers, creating new guideline documents by dispersing the existing guidelines along the lines of region, capitalization, and market segment would likely make it more challenging over time for the Board to keep track of what policies it has approved across the equity landscape and introduce the risk of inconsistency and error between these policy documents. Staff, therefore, recommended that the Board affirm its existing investment guidelines.

MR. TRIVETTE moved that the ARMB affirm the existing Investment Guidelines for Domestic and International Equities in Resolution 2012-08. COMMISSIONER BUTCHER seconded. The motion passed, 7-0.

MR. SIKES reviewed IFS recommendation A-1.b, #5, Investment Reporting to the Board. This recommendation regarding fee disclosure appears to be motivated by the desire to ensure that investors are considering fees when selecting investment funds. In the case of all participant-directed plans, the participants are the investors and the Division of Retirement & Benefits reports this information on their web site. Participants should be fully informed regarding fees when selecting funds. As it relates to ARMB considering new options, the fee analysis is part of the hiring process, which is separate from the Callan defined contribution report. Asking Callan to reproduce what is already being reported by the Division of Retirement & Benefits is unnecessary. Staff recommended affirming the current fee reporting process.

MS. HARBO moved that the ARMB affirm the current fee reporting process via the Division of Retirement and Benefits. MR. TRIVETTE seconded. The motion passed, 7-0.

MR. SIKES reviewed IFS recommendation B.8, #1, to adjust the quantitative factors in the Manager Watch List guidelines to accommodate passive index investment managers. Staff believes it is unnecessary to create adjusted Watch List guidelines for passive investment managers. All managers are subject to the existing Watch List guidelines. While the recommendation appears to straightforward and suggests of tight tolerances around index returns for passive mandates, external cash flows (meaning transfers in and out of the account) can create significant tracking error to the index return. This tracking error does not reflect poor management but rather is the incidental byproduct of market performance during transfer periods and performance calculation methods. Therefore, implementing tight quantitative Watch List guidelines for passive mandates is likely to produce false indications of poor management. Staff monitors daily performance of all accounts. For passive managers, any significant deviation from the benchmark, positive or negative, will trigger follow-up with a manager. If poor performance compared to the index is a legitimate concern, staff will recommend the manager be placed on the Watch List as part of its daily monitoring activities. Staff, therefore, recommended affirmation of the existing Watch List guidelines.

MS. HARBO moved that the ARMB affirm the existing Watch List Guidelines in Resolution 2006-01. MR. TRIVETTE seconded.

MR. TRIVETTE made a friendly amendment to the second paragraph of the Watch List guidelines to replace ASPIB with ARMB. There was no objection to the amendment.

MR. O'LEARY stated that there are more likely to be significant apparent differences in performance in the passive assets managed within the defined benefit program attributable to rebalancing changes. That has been a particularly troublesome area in the small cap equity pool, and each of those instances of significance difference in performance has been something that the ARMB staff has monitored, investigated and accepted the consequence of, as Mr. Sikes outlined.

MR. JOHNSON said there have been previous discussions about not wanting to create a situation where an investment manager might theoretically have a contract claim based upon the resolution saying that they did or did not follow certain guidelines. IFS suggested tightening up the tolerances around the index, and the Board has thought about this a number of times and has rejected it. That is another reason to support the recommendation by Mr. Sikes.

The motion passed, 7-0.

MR. BADER reviewed IFS recommendation B.2.1, which recommended amending the rebalancing policy so that it refers to ranges that are found in the annual asset allocation resolutions. He said staff concurred with the recommendation and had prepared a redlined resolution to make that change to policy.

MS. HARBO moved that the Alaska Retirement Management Board adopt Resolution 2012-17, which amends the Rebalancing Policy to reference the ranges that are found in the annual asset allocation resolutions. COMMISSIONER BUTCHER seconded. The motion passed, 7-0.

17. Investment Actions

17(a). Contract Extensions: Callan Associates, Inc., Townsend Group LLC, and Gabriel Roeder Smith

MR. BADER stated that the current consulting contract with Callan runs from July 1, 2009 to June 30, 2012, with two optional one-year extensions. In consultation with the commissioner, staff recommended exercising the first optional one-year extension through June 30, 2013.

MR. PIHL moved that the Board direct staff to exercise the first one-year contract option, extending the consulting contract with Callan Associates, Inc. until June 30, 2013. MS. HARBO seconded.

MR. TRIVETTE said the Board spent a considerable amount of time and effort on the selection of a general consultant the last time around, and he continued to be very pleased with the work of Callan Associates.

The motion carried unanimously, 7-0.

MR. BADER stated that the Board's contract with The Townsend Group LLC runs from April 1, 2009 to June 30, 2012, with two optional one-year extensions. Staff recommended that the Board exercise the first of those one-year extensions.

MS. HARBO moved that the Board direct staff to exercise the first one-year contract option, extending the contract with The Townsend Group LLC until June 30, 2013. COMMISSIONER HULTBERG seconded. The motion passed, 7-0.

MR. BADER said the contract period with Gabriel Roeder Smith & Company (GRS), the reviewing actuary for the ARMB, runs from February 1, 2006 to June 30, 2010, with three optional one-year extensions. The second one-year extension runs through June 30, 2012. Staff recommended that the Board exercise the final one-year optional extension of the GRS contract to June 30, 2013.

MR. PIHL moved that the Board direct staff to exercise the final one-year contract option, extending the contract with Gabriel Roeder Smith until June 30, 2013. MS. HARBO seconded. The motion passed, 7-0.

17(b). Actuary Procurement

MR. BADER reviewed the written staff report in the packet outlining the Board's authority for, and the process for, issuing a Request For Proposal (RFP) for an independent audit of the state's actuary. He requested the Board's approval to go ahead with an RFP.

MS. HARBO moved that the Board direct staff to prepare an RFP for an independent audit of the state's actuary to be conducted during fiscal year 2013. MR. TRIVETTE seconded.

MR. TRIVETTE made a friendly amendment that "...the Board direct staff to prepare and issue an RFP..." There was no objection to the amendment.

CHAIR SCHUBERT asked what the audit would cost. MR. BADER recalled that it was $125,000. He added that the independent audit is a statutory requirement, and the last one was a full replication audit, which explains the cost.

MR. PIHL questioned if a full replication audit was necessary, given that GRS is the reviewing actuary that certifies the work of the state's actuary. He wondered if the Board could consider an approach to the independent audit that was less costly than a full replication.

MR. JOHNSON read the provision in AS 37.10.220(a)(10) that provides for contracting an independent audit no less often than once every four years. He said the statute does not define what an independent audit is, nor does it describe who an independent auditor might be, and it certainly does not say that the audit has to be a full replication. He said there are some grounds for interpretation. Given the Audit Committee disclosures yesterday from KPMG that they engage in some measure of an audit of the actuary, and that KPMG itself is an independent auditor, maybe there is grounds within the framework of that contract to consider it. He said his comments were impromptu, without having the opportunity to flesh them out.

MR. BADER stated that the work GRS performs is not a full replication audit: they look at test lives and many of the actuarial inputs in order to certify the work that Buck Consultants has done. The Board has a history of taking a very conservative view. ARMB does a complete audit every year and does not do a partial audit. He said it is a policy call for the Board, but he felt there had been issues involved with a [prior] actuary and the quality of the data in the past. He reminded everyone that the last time a problem occurred with the actuarial valuation it was as a result of work performed by an outside auditor with no experience with the retirement system that came in and identified the problems that exist. The Board could do something less and everything would probably be okay. Staff has no reason to doubt that the state actuary is giving good information. But he thought the statute was in place so the Board could be as certain as it could possibly be that the numbers it is getting are reliable. It was staff's recommendation to proceed with an independent audit as in the past.

MR. TRIVETTE voiced his support for staff's recommendation because the certifying actuary only looks at one test life when conducting the reviewing audit. He thought $125,000 was a very rational expenditure when taken in the context of a $18-$19 billion retirement fund.

COMMISSIONER BUTCHER concurred with Mr. Trivette and said it was better to err on the conservative side, given what the Board has gone through in the recent past.

CHAIR SCHUBERT said the Board's direction to staff was to go forward [with the RFP] as they have done in the past.

The motion passed unanimously, 7-0.

17(c). ARMB Delegation of Authority

MR. BADER reviewed the written staff report in the meeting packet *[on file]* regarding tightening up the delegations to the chief investment officer.

<u>MR. TRIVETTE moved that the Alaska Retirement Management Board approve Resolution 2012-18, modifying the delegation of authority to grant the chief investment officer authority to approve investment manager requests to name ARMB in publications and written materials</u>. <u>MS. ERCHINGER seconded</u>. The motion carried unanimously, 7-0.

UNFINISHED BUSINESS

1. Meeting Calendar

MS. HALL pointed out the addition of an October 17 Audit Committee teleconference meeting on the 2012 calendar. The proposed 2013 meeting calendar was presented in the packet for the Board's approval.

MS. HARBO moved to adopt the proposed 2013 ARMB meeting calendar. MR. TRIVETTE seconded.

COMMISSIONER HULTBERG noted that the Chair had repopulated the health care committee yesterday, and some meetings for that would have to added to the calendar later.

MR. TRIVETTE suggested that the Legislative Committee would have to schedule meetings as well. He thought meetings for other committees would be added along the way.

The motion passed, 7-0.

2. Disclosure Reports

MS. HALL stated that the disclosure report was included in the packet as required, and there was nothing unusual to report to the Board.

3. Legal Report

MR. JOHNSON said he had no specific new legal issues to bring up, other than to suggest that the Board look at its Policies and Procedures Manual and update it. The references in there are all to ASPIB and to ASPIB statutes that the ARMB adopted in 2005, when the ARMB assumed a lot of the resolutions and previous practices from ASPIB.

NEW BUSINESS - None.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD - None.

PUBLIC/MEMBER COMMENTS

INVESTMENT ADVISORY COUNCIL COMMENTS - None.

TRUSTEE COMMENTS

MR. TRIVETTE said he goes back and reads the minutes of recent meetings because it reminds him of items the Board has covered. He especially appreciates the Investment Advisory Council comments, in particular Dr. Jennings' comments about investment size at the April meeting. He said the ARMB came into being at a difficult time in terms of the status of PERS and TRS funding, and he agreed with Mr. Bader that the Board needs to get the best possible information from the people it works with. The Board is making better use of its meeting time, partly due to the dedication of the trustees but also to the staffs of both departments. He asked the commissioners to convey to their staffs that the Board appreciates their work and dedication. There was a planning session last May that was beneficial, and he thought the Board should take a look at that again in the fall to see if there were items the trustees wanted to still do.

MS. HARBO offered a thank-you to outgoing trustees Tom Richards and Mike Williams and said she appreciated their work and would miss them very much.

MS. ERCHINGER thanked Commissioner Hultberg for engaging the Board in discussions about health care. She regarded that as a valuable contribution. She also thanked Tom Richards and Mike Williams and said she would miss them. Lastly, she thanked Teresa Kesey for her work on behalf of the Board and wished her well in her new job.

CHAIR SCHUBERT also thanked Mr. Williams for his service on the Board, saying he was a terrific help to her at times when sticky parliamentarian questions came up. She thanked Mr. Pihl for all the work he did on the motion the Board adopted yesterday.

FUTURE AGENDA ITEMS - None.

ADJOURNMENT

There being no objection and no further business to come before the board, the meeting was adjourned at 10:40 a.m. on June 22, 2012, on a motion made by Ms. Harbo and seconded by Commissioner Hultberg.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Gayle Harbo

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.