State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
Meeting

Location
Anchorage Marriott Hotel
820 West Seventh Street
Anchorage, Alaska

MINUTES OF
February 12-13, 2013

Tuesday, February 12, 2013

CALL TO ORDER

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

ROLL CALL

Nine ARMB Trustees were present at roll call to form a quorum.

Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Kristin Erchinger
Commissioner Becky Hultberg
Martin Pihl
Tom Brice
Sandi Ryan
Commissioner Bryan Butcher

Board Members Absent
None

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

Investment Advisory Council Members Absent
George Wilson

Department of Revenue Staff Present
Angela Rodell, Deputy Commissioner

Gary M. Bader, Chief Investment Officer
Bob Mitchell, State Investment Officer
Pamela Leary, State Comptroller
Judy Hall, Board Liaison

Department of Revenue Staff Absent
Zach Hanna, State Investment Officer
Steve Sikes, State Investment Officer
Scott Jones, Asst. State Comptroller

Department of Administration Staff Present
Jim Puckett, Director, Division of Retirement & Benefits
Mike Barnhill, Deputy Commissioner

Consultants, Invited Participants, and Others Present
Robert Johnson, ARMB Legal Counsel
Michael O'Leary, Callan Associates, Inc.
Paul Erlendson, Callan Associates, Inc.
Mark Weisdorf, J.P. Morgan Asset Management
Amy Cummings, J.P. Morgan Asset Management
Doug Bratton, Crestline Investors, Inc.
Curt Futch, Crestline Investors, Inc.
Eric Wolfe, Prisma Capital Partners, LP
Helenmarie Rodgers, Prisma Capital Partners, LP
Justin Richards, Mondrian Investment Partners
Dan Philps, Mondrian Investment Partners

PUBLIC MEETING NOTICE

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

APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda. Mr. Brice seconded the motion.

The agenda was approved as presented.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

JAY DULANY, President of the Retired Public Employees Association (RPEA), expressed thanks for handling retiree trust funds. MR. DULANY expressed concern about unfunded liability.

APPROVAL OF MINUTES

MR. PIHL moved to approve the minutes of the December 6-7, 2012 meeting, as presented; MS. RYAN seconded the motion.

The minutes were approved without changes.

REPORTS

1. CHAIR REPORT

CHAIR SCHUBERT did not have anything to report, but requested that the agenda item “Investment Decisions” be moved to February 12th, instead of February 13th.

2. COMMITTEE REPORTS

A. Audit Committee

MR. PIHL reported that the Audit Committee met February 11, 2013; the main focus of the meeting was the Employer Audit Program, which has shown great improvement but the committee is looking for clarification as to the audit frequency and financial impact of findings. MR. PUCKETT will bring suggestions and further information to the committee at a future meeting.

MR. PIHL reported the committee receives monthly reports regarding the Compliance Audit Program in Revenue, and there have been no significant findings.

MR. PIHL noted the committee will receive a report from DRB at its next meeting on best practices regarding Employer Audit Programs by other states and employers.

3. RETIREMENT & BENEFITS DIVISION REPORT

A. Membership Statistics/Buck Invoices/HRA Rates

DIRECTOR PUCKETT reported that to date in FY13, 1,102 retirements have been processed, a higher number than in the past which raises concern given the increase in workload. MR. PIHL asked about Terminated Members, and DIRECTOR PUCKETT stated some are vested and some are not. DIRECTOR PUCKETT stated he will check with Finance to request that that line be split.

MS. HARBO asked about the Buck invoice charges dealing with GASB 67 and 68; MR. BARNHILL stated it was done at his request and it will not be billed to the Trust Funds.

MS. HARBO asked about the terms “withdrawn” and “full disbursements.” DIRECTOR PUCKETT stated if there is full disbursement, there is no money left in the account.

MS. ERCHINGER questioned Buck’s hourly rate which appeared to be about $300 per hour. DIRECTOR PUCKETT stated Buck’s hourly rates vary from $175 to $350 per hour, depending on who is doing the work. MS. ERCHINGER asked if there is a less expensive way to get the information. MR. BARNHILL stated that staff has done research on the cost of actuaries and found that the Florida Board of Pensions posted the hourly rates of the major actuarial firms and it all shows hundreds of dollars per hour. He stated that understanding actuarial costs and ensuring that costs not related to the administration of the retirement system are billed to the trust funds is a concern. He noted that he and MS. ERCHINGER will be working on a proposal that might appear on the next agenda.

MR. TRIVETTE asked for definitions of RHF and AHF; DIRECTOR PUCKETT stated RHF is Retiree Health Fund, and the AHF is Active Health Fund. He indicated his interest in following up on actuarial survey charges and the cost of having actuaries on staff.

MR. BARNHILL noted there are separate contracts, an actuarial contract for the pension side and an actuarial contract for the health consulting side. Both are with Buck. On the health side, that contract expires at the end of this fiscal year, and they will be issuing an RFP to procure for that.

MR. TRIVETTE stated the State used to have a contract with healthcare consultants and asked if there is a third contract or all rolled into the actuary contracts. MR. BARNHILL stated Buck was the prevailing bidder in the last cycle.

DIRECTOR PUCKETT stated there is an information memo regarding health reimbursement arrangements for the employers. The calculated amounts have been shared with the participating employers, and the information is available for the Trustees. MS. HARBO asked what happens to the account for the DC members that are withdrawn or have a full disbursement, and DIRECTOR PUCKETT stated they cannot access the money unless they've retired.

MS. HARBO asked about major medical, and MR. BARNHILL stated employers contribute the three percent into the HRA account, and to vest, one has to be in the system for five years. MR. BARNHILL noted that extensive internal discussions and research had taken place with respect to HRA accounts for employees who do not vest and whether those funds revert to employers; this drives actuarial projections about how long and HRA account would last so the division is interested in pinning that down. With respect to major medical, Buck will bring that rate to the Board for review at the April meeting and will propose an increase to that rate.

MR. TRIVETTE inquired about the cost of maintaining the individual accounts and how often participants are advised of account balances. DIRECTOR PUCKETT replied that he would investigate the administrative costs of the system, but that providing account balances should be provided next year. MR. TRIVETTE asked that information as to the account balances be provided to the board as well.

B. Legislative Report

MR. BARNHILL reported on SB30, which is Senator Egan's bill providing for a choice between a Defined Benefit and a Defined Contribution plan which is currently undergoing an actuarial analysis. SB48 is a new bill that is prompted by the Alaska Municipal League. This bill exempts or eliminates the 2008 salary floor requirement for those municipalities that have had a change in population, a decrease in population of 25% or more between the 2000 census and the 2010 census.

MR. PIHL and MR. BRICE stated concerns regarding the 22% portion that goes to the unfunded liability. MR. BARNHILL said the basic way to address it is what the Board has done and that is to set rates that are equivalent to the actuarially required contribution. MR. BARNHILL noted the Board is fulfilling its statutory duty to set rates, and it is doing so appropriately. HB102 does a variety of things regarding attachment of retirement proceeds and crediting and community property and that is being evaluating with the Department of Law. HB106, by Representative Kerttula, would permit deduction of dues, retiree organization dues, from a pension check; it's the same as HB135 last session.

COMMISSIONER HULTBERG stated there should be an additional agenda item and/or the Legislative Committee should have further discussion; MR. BRICE stated he will note it under New Business. MR. PIHL complimented Commissioner Hultberg and Deputy Commissioner Barnhill on their presentation to the legislature

MS. ERCHINGER expressed her thanks regarding the salary floor discussion and th continuing dialog regarding SB48.

4. TREASURY DIVISION REPORT

Department of Revenue Deputy Commissioner ANGELA RODELL reported an action item would be required from the Board. The ARMB contract with State Street, its custodial bank, will expire on June 30, 2013. The Board has three one-year optional extensions. The extensions do not have fee schedules attached to them, but Staff and Department of Law have been working to arrive at a fixed fee for the next three years. The Division recommended that the Board approve an extension for the next three years. The ARMB paid a flat fee in 2002 of $1,092,000 million, and for fiscal year 2013, it will be $1,118,000, and then will be locked for the next three years at $1,229,800. The recommendation is to direct staff to exercise the three one-year renewals at the flat fee, so the contract would expire June 30, 2016. She noted that daily plan accounting program is finally underway, and to have three years to experience daily plan accounting under this contract extension would be important and should a new custodian be selected in the future, the transition should be somewhat easier.

<u>MR. PIHL moved to direct staff to exercise the three-year contract extensions with State Street regarding custody services</u>; <u>the motion was seconded by MS. ERCHINGER</u>.

MR. TRIVETTE stated there is no need to go out for an RFP.

COMMISSIONER HULTBERG asked if the contract was exempt from the procurement code; MR. JOHNSON stated the custodial function is pursuant to a delegation so it is not required to go through standard procurement processes, but the Board can elect to go through with RFP process.

Motion carried unanimously.

5. CHIEF INVESTMENT OFFICER REPORT

MR. BADER reported on several rebalancing of the retirement funds to return the funds to the target asset allocation. He next described responses to participants' questions relating to having a metals fund, brokerage account and money market options. MR. BADER noted that the Defined Contribution Plan Committee would meet in the near future to discuss the DC Plan options. He reported on a communication from EIG in support of TCW's acquisition by the Carlyle Group, stating that the board does not have a role in the process, it is informational.

MR. BADER stated that following the termination of Capital Guardian emerging markets, $350 million was transferred to an ACWI Ex-US index fund. McKinley Capital was reduced the $25 million to try and bring things more into balance with international investments. The Equity Yield Strategy indexed to the Dow 100 approved by the Board last April was funded with $100 million from a cash account indexed.

MR. BADER noted the next item was a request for permission to change investment contracts to reflect a name change from RCM Capital Management to Allianz. MR. JOHNSON stated that clarification should be included for assumption of liabilities for actions related to the prior contract. MR. BADER requested a motion that the Board approve these name changes, subject to the concurrence of legal counsel.

MS. HARBO moved that the Board approve these name changes, subject to the concurrence of legal counsel; MS. RYAN seconded the motion.

Motion carried unanimously.

MR. BADER noted RCM invests in a Defined Contribution Plan, known as the ESG account, also in Buy-Write, and in a large cap core growth fund. All three of these funds would have the name change.

MS. HARBO inquired about the progress on the actuarial audit and its timeline and when a final report will be done. MR. BADER stated the contract has been signed, the auditors are in contact with the Buck Consultants, and they are in the process of exchanging information.

6. FUND FINANCIAL REPORT

Comptroller PAMELA LEARY reported the total PERS system had $12.4 billion at December 31st. The Teachers' system had $5.1 billion. The Judicial system had $135 million. The National Guard Naval Militia had $34 million. The Supplemental Annuity Plan had $2.8 billion, and the Deferred Compensation Plan was $644 million. The total for all funds at December 31st was $21.192 billion.

MS. LEARY reported Non-Participant Directed assets at $17.360 billion, and the Participated Directed funds at $3.8 billion. At January 31st, the number for the Non-Participated Directed went up $17.7 billion, and as of February 8, 2013, was at $17.8 billion, so an increase of income by about a little over 8.5% for the seven months. During the month of December, investment income contributed to an increase of about 1.3% in increase of assets.

DIRECTOR PUCKETT reported, for the six months ending December 31, 2012, $478 million in contributions have been received from employers and members. With the legislative relief and other income, that is a total of $1.1 billion in total contributions received year-to-date. Of the $725 million paid out in benefits so far this year, 68% is Defined Benefit pension payments to PRS, TRS, and JRS retirees. The other 32% is meant to provide medical care for those retirees and their dependents. For the month of December, over $90 million in contributions were received, and over $123 million in benefits was paid out, and $17 million in refunds and disbursements were processed during the month.

MS. ERCHINGER requested MS. LEARY add a column to the schedule, the Non-Participant Directed Plans, distinguishing the difference between the percent change, beginning and ending balance percent change, due to the invested assets versus investment income. MS. LEARY indicated she would add that.

7. INFRASTRUCTURE

A. INTRODUCTION TO INFRASTRUCTURE
Gary Bader, Chief Investment Officer

MR. BADER reminded Board members that at the October Education Conference, a presentation was given by Joe Azelby of J.P. Morgan Asset Management called "The Realization." Included in the presentation was a section on infrastructure. MR. BADER noted a major asset group missing from the ARMB's Real Assets Allocation is infrastructure.

MR. BADER noted infrastructure is a group of investments that include the basic physical systems of a business or of a nation or of a state. As an asset class, infrastructure is a defensive asset class and tends to be less volatile than publicly traded equities, with the following characteristics: high barriers to entry due to cost and low price elasticity. MR. BADER invited AMY CUMMINGS and MARK WEISDORF from J.P. Morgan Asset management to explain investing in infrastructure.

B. INFRASTRUCTURE
J.P. Morgan Asset Management

AMY CUMMINGS with the Global Real Assets Group of J.P. MORGAN and MARK WEISDORF reported on Infrastructure Investing. *[A copy of this presentation is on file at the ARMB office.]*

MS. CUMMINGS reported infrastructure has been a consistent performer, a growing cash flow investment, low volatility, and a proven diversifier, including during the recent economic downturn. She provided a summary of Mr. Weisdorf's background, noting his 30 years of investment experience. He has developed the J.P. Morgan infrastructure platform with 30 professionals and $7 billion in assets under management. MS. CUMMINGS said the goal was to provide a snapshot of the infrastructure investment – its characteristics, benefits, the outlook and current timing.

MR. WEISDORF reported institutional investors in infrastructure, over the past six to eight years, have been experiencing the realization described by Joe Azelby. He stated that with fixed income generating insufficient returns to meet actuarial requirements, and the volatility in the equity markets, de-risking a portfolio by taking some volatility off the table.

MR. WEISDORF noted four major groups in the infrastructure space made up by regulated utilities, transportation assets, social infrastructure, and communication infrastructure. MS. CUMMINGS noted the characteristics of infrastructure as: income, low volatility of returns, diversification, inflation protection, and long-term liability matching.

MR. WEISDORF described the risks of infrastructure, particularly regulatory and political risk since these assets are essential to the communities that they serve. Liquidity is another risk, but mitigated by earning a premium for holding illiquid assets. He next discussed the stage of development in building a new asset taking on construction or development or utilization risk, or investing in existing assets with 30 or more years of operating history. MS. CUMMINGS noted this is a compelling asset class, and she made the case for the income and the low volatility and also for the timing of it. MS. CUMMINGS noted it's a more established asset class than it was previously.

COMMISSIONER HULTBERG inquired about how sensitive this asset class is to the health of public sector finances. MR. WEISDORF stated having the qualified sector invest in the asset class or in the asset takes it away from the risk of being dependent on public sector financing.

MR. TRIVETTE asked about timing; MR. WEISDORF stated, for a year or two, they still see attractive opportunity. MR. TRIVETTE inquired about how to pick a top quartile manager versus just an average one; MS. CUMMINGS stated to ask their consultants.

DR. MITCHELL asked, once these assets are in a portfolio, how frequently are they priced, who prices them, and what's the liquidity if you want to sell it? MR. WEISDORF stated it varies from manager to manager, but generally quarterly appraisals and valuations, and then annually each asset is valued by auditors.

MR. ERLENDSON asked, what are the challenges to investors in terms of actually realizing capital gains? MR. WEISDORF replied that this is still a newer investment strategy worldwide, so we don't have the same liquidity that we do for real estate, the strategy is to grow the cash flows over time.

CHAIR SCHUBERT thanked the presenters for presentation and recessed meeting from 10:46 a.m. to 11:00 a.m.

8. ABSOLUTE RETURN/PORTFOLIO STRUCTURE DISCUSSION

MR. BADER reported, on December 18, 2012, MR. O'LEARY, MR. ERLENDSON, DR. JENNINGS, DR. MITCHELL, GEORGE WILSON, JUDY HALL, and he met in New York City to discuss unfinished items from the August meeting in Denver. There were three major topics: 1) creation of an asset class called "Other"; 2) active versus passive strategies; and 3) Absolute Return asset class.

MR. BADER noted the goal of the ARMB's Absolute Return policy is to try and earn a five percent real rate of return with low volatility and low correlations to the other asset classes in the portfolio.

As a result of the meeting, it is being recommended that the Board adopt a more opportunistic and less constrained Absolute Return strategy. The revised program would focus on producing higher returns with the ability to take on additional risk and market correlation. Significant changes would include investing in a combination of strategies that, in the aggregate, would include volatility that ranges from five to ten percent as opposed to the previous targets of four to six percent. In addition, the beta, the correlation with the other asset classes, like stocks and bonds, could rise to as much as 50% over rolling three-year averages.

MR. BADER reported GAM, Prisma, and Crestline came before the group and presented investment strategies that they felt might achieve the stated goal.

MR. BADER noted there will be an action item later in the agenda, which would presume to expand the investment policies to allow the investment approaches that will be shown later in the meeting.

MR. TRIVETTE expressed thanks and appreciation to MR. BADER and IAC and the rest of the staff for engaging this topic.

9. CRESTLINE INVESTORS, INC.

DOUG BRATTON, Founder and CIO of Crestline, presented on Crestline's opportunistic strategy capability. *[A copy of this presentation is on file at the ARMB office.]*

Senior Portfolio Managers for the strategy, CURT FUTCH and KEITH WILLIAMS, accompanied MR. BRATTON, and background information was provided on the experience and careers of the presenters that highlighted the specific skills to execute the strategy.

MR. BRATTON stated Crestline proposes to modify the Blue Glacier account (the existing account) to an opportunistic mandate. Strategies pursued will be primarily long only versus hedge funds. The Blue Glacier account would be a separately managed account, but pursuing the Opportunity Fund II strategy instead of the existing hedge fund strategy.

Crestline has $7.3 billion of firm assets under management and 93% of those assets under management are from institutional investors.

MR. BRATTON discussed opportunistic investing, noting it has a one to three year average life expectancy, and it has a 12% to 16% return net expectation in today's market. It's transparent, and it has a shallow J-curve. MR. BRATTON noted Crestline has an industry-leading position in opportunistic private credit strategies.

MR. BRATTON noted, as far as the actual allocation of the existing Opportunity I Fund, the current allocation is about 30% cash flow strategies, 11% opportunistic credit, distressed corporate, and then hedge fund secondaries to make up the allocation of the current fund. The fund was started back in 2005, and it was a $400 million capital base, funded by two large pension partners, North American pension plans. As far as returns, over the period of September 2005 to 2012, about 11% compounded return was generated, which is double the S&P and bond market and much greater than the Hedge Fund of Funds index.

MR. TRIVETTE asked if Crestline anticipates additional fees to move the strategy to opportunistic and inquired about the timeframe on the Shallow J-curve. MR. BRATTON noted one to three years is defined as a Shallow J-curve.

MR. ERLENDSON inquired about expectation about the variability around the target rate of return. MR. BRATTON stated he would put it squarely in the center.

MR. BRATTON discussed investment structuring, portfolio construction, and risk management.

MR. BRATTON discussed the proposal to modify the existing account, including a $250 million account of which up to 100% will be allocated from the existing hedge fund portfolio to the new mandate. A separate share class will be created in the existing fund, and as investments are added to the new share class, the existing investments will be liquidated to fund that share class. It is a two-year investment period. At the end of two years, it would go into run-off and become self-liquidating, and the continuation of the program will be at the option of the ARMB Board.

Crestline proposed a reduced management fee of 75 basis points and a performance fee that would only be 10%, which would only be implemented after the ARMB Board received a 6% return and all its capital back.

MR. O'LEARY inquired about the overall fee structure. MR. BRATTON stated the existing fee structure is 0.83 basis points, 85 basis points. Crestline proposed reducing the existing management fee from 0.85 basis points to 0.75. In return for that, Crestline proposed a performance fee based only upon realization of capital and a return. There is no performance fee that exists today.

MR. O'LEARY confirmed that fee is only on performance above six percent; MR. BRATTON stated that is correct. ARMB would receive 100% of its capital back, plus a six percent internal rate of return, and then share the profits 90/10 above that. MR. O'LEARY inquired if that pertains only to the new investments made; MR. BRATTON stated yes; for comparison purposes, Crestline's existing fee structure for these accounts is 1.25% and 10% over the 6% return. Crestline proposed a substantial decrease in fees based on the size of the account.

DR. MITCHELL inquired about deal flow benefits from current market dislocations, Crestline's view on how long the market dislocations will last, and if we at the end or beginning of the liquidating hedge fund period and the end of the prop desk disappearance. MR. FUTCH stated, from a prop desk perspective, those institutions have a decreased appetite for risk. MR. BRATTON confirmed two to three years of good visibility.

MR. BADER inquired, if the fund would earn more than six percent, then the surplus over six percent would be split 90/10, to which MR. BRATTON replied, yes, and stated the fee schedule is based on realization only, so IRR and liquidation, not an annual fee schedule. ARMB would receive the money back, then a return, and then Crestline would participate.

CHAIR SCHUBERT thanked the presenters for presentation and recessed meeting from 11:31 a.m. to 1:14 p.m.

10. PRISMA CAPITAL PARTNERS, LP

CO-CHAIR TRIVETTE called the meeting back to order.

MR. BADER welcomed ERIC WOLFE and HELENMARIE RODGERS from PRISMA CAPITAL who gave a presentation on PRISMA CAPITAL PARTNERS, LP. *[A copy of this presentation is on file at the ARMB office.]*

MS. RODGERS reported about Prisma and gave an update on the firm, post-transaction with KKR. MS. RODGERS reported Prisma did a transaction with KKR and is now part of a broader financial institution. Prisma has over $8.0 billion in assets under management, and 90% of that is managed on behalf of institutional clients.

MS. RODGERS reported, on the performance side, the low volatility composite consistently outperformed the HRFI Hedge Fund of Funds Index by a little over 300 basis points per year and T-Bills by 422 basis points per year since inception of this composite.

MS. RODGERS stated Prisma continues to feel very strongly about the ability to generate alpha in the hedge fund asset class and the flexibility that hedge funds have in terms of multiple opportunity sets across the strategy. It continues to be both a return generator and a risk diversifier for clients.

MR. WOLFE talked about the proposal for the portfolio specifically, the strategy outlook for the world, and different hedge fund strategies. MR. WOLFE reported the Polar Bear Fund was up nearly three percent in the fourth quarter. MR. WOLFE reported the long/short equity strategy is what Prisma is the most excited about for the next couple of years, and the areas Prisma is least excited about is strategies like convertible bond arbitrage.

MR. O'LEARY inquired about percentages in long/short equity. MR. WOLFE stated, instead of having 35 managers, Prisma would propose having closer to 15 managers.

MR. BRICE requested MR. WOLFE talk in more specificity in terms of Prisma's Asian target. MR. WOLFE stated it's multifaceted in terms of the different types of investment strategies that Prisma finds attractive in Asia.

MR. ERLENDSON inquired about the trading activity Prisma would expect with its view of the future for this strategy and what sort of turnover volume the underlying assets would involve. MR. WOLFE stated it depends a lot on the individual strategies.

MR. BRICE inquired if the target was seven percent. MR. WOLFE stated the return to cash is measured by three-month T-Bills over the last year. It has been about 0.1%. The total return target for the program has been about 5.1%, and including January, it was at about 4.92% total return, very close to the target objective for the program.

MR. TRIVETTE inquired if there are any additional fees or costs to the ARMB Board for the restructuring, and as to how long it will take to transition all the way to be 100% done with the restructure. MR. WOLFE stated there are no additional costs involved in the restructuring. The time horizon is ARMB will get about 90% of the way there within three months. The last five percent may take up to nine months to 12 months, but ARMB will get almost all the way there within three months.

CHAIR SCHUBERT thanked the presenters for presentation and recessed meeting from 1:51 p.m. to 1:57 p.m.

14. INVESTMENT DECISIONS (note: *change in agenda to item 14, due to time allowance*)

CHAIR SCHUBERT called the meeting back to order and noted Investment Decisions will be moved to this point in the agenda.

A. Absolute Return Policy Change Action: Resolution 2013-01

MR. BADER reported that changes in the Board's policy regarding Absolute Return will be necessary in order for Crestline and Prisma/KKR to implement those changes. *[A copy of this presentation is on file at the ARMB office.]* The first change is that the volatility constraints have been relaxed to a point where volatility would now be between that of bonds and equity. The range has changed from four to six percent to between five and ten percent, so more volatility in this new asset class can be expected.

MR. BADER noted, secondly, individual manager investment guidelines would be set in writing by the CIO, and the policy would ask that ARMB try to achieve the policy objectives within the total program, not just singularly with each investment manager.

MR. BADER noted, thirdly, the investment return goal is a return in excess of a portfolio composed of 70% MSCI All Country World Index and a 30% Barclay's Capital Aggregate Bond Index, and fourth, beta exposure should not consistently exceed 0.50%. Fifth, liquidity targets are relaxed and based upon the program rather than that of an individual manager. Sixth, managers may make investments through closed-end funds or other structures not subject to the liquidity guidelines, if they have the CIO approval. And lastly, managers may run a more concentrated portfolio and hold as few as ten investment funds down from a previous requirement of 20.

MR. BADER asked for a motion that the Alaska Retirement Management Board adopt Resolution 2013-01, revising the Absolute Return Policies and Procedures to accommodate a more opportunistic and less constrained approach to Absolute Return.

MR. TRIVETTE moved to adopt Resolution 2013-01; MS. HARBO seconded the motion.

MS. ERCHINGER expressed concerns about reconsidering being in the Absolute Return asset class, and asked, if it is best to get out of the asset class all together and find another place to put money or just change the constraints put on the asset class to get the higher return. MR. BADER discussed the option of the "Other" asset class.

MR. BRICE questioned the validity of the Board's constraints. MR. BADER noted one of the things it also says in the Action Memo is ARMB wants a demonstrated history of success in these asset classes. MR. BADER noted Prisma, by and large, has met the expectation; the other two have not. MR. O'LEARY stated one of the things that has been put on the table is that Absolute Return is not an asset class.

DR. JENNINGS stated the Board suffered from self-imposed constraints. On diversification, DR. JENNINGS thinks it's perhaps less diversified, but it is still diversifying, and some of these strategies are going to smooth out the overall portfolio volatility. PRISMA and CRESTLINE will be able to reallocate resources much more quickly than a board-driven process.

MS. ERCHINGER expressed thanks for the additional explanation, and COMMISSIONER BUTCHER stated he is interested in taking this step.

Upon a roll call vote, the motion carried unanimously.

MR. BADER asked the Board to approve the removal of KKR/Prisma from the watch list.

MS. HARBO moved to approve the removal of KKR/Prisma from the watch list; the motion was seconded by MS. ERCHINGER.

MR. O'LEARY confirmed he did not provide advice in this regard because his daughter is a partner at KKR.

Motion carried unanimously.

B. Asset Class Addition: Other Equity

MR. BADER discussed the creation of an "Other" asset class, and there is an Action Memo regarding this topic. The ARMB currently has seven asset class buckets designed to group investments based on similar characteristics and performance patterns. MR. BADER noted this topic was discussed at a meeting with Callan and the IAC on December 18, 2012, and another asset class was the recommended direction to go in for these assets. The benchmark for this asset class would be 50% S&P 500, 30% Buy-Write Index, and 30% Convertible Bond Index. MR. BADER noted, effective July 1, 2013, the Alaska Retirement Management Board would create a new asset class called "Other" to house current and future investments that do not properly fit into the ARMB's current asset class structure.

MR. BRICE moved to create an "Other" asset class; the motion was seconded by MS. RYAN.

DR. JENNINGS suggested the label "Other Equity." MR. JOHNSON raised the question if the "Other" category is too broad. MR. O'LEARY noted it would not be grouped in the "Other" category, unless the Board acted to approve it.

MS. RYAN stated she likes the idea, but not the name because it doesn't have transparency. MR. BADER noted it was labeled "Other" because it has convertible bonds in it, and it would be very equity centric in terms of its approach. He would not be opposed to labeling it "Other Equity." MR. O'LEARY suggested "Low Volatility Equity."

MR. BADER suggested, if agreeable to Board members, the term "Other" would be used until the Board found a more descriptive name, and it could be changed. He would work with Ms. Ryan and others to create a new name.

Motion carried unanimously.

C. Infrastructure Manager Search

MR. BADER asked for a motion from the Alaska Retirement Management Board to direct staff to engage Callan and Associates to conduct a search for one or more infrastructure managers. Both private and public investment strategies should be considered.

MR. BRICE moved that the Alaska Retirement Management Board direct staff to engage Callan and Associates to conduct a search for one or more infrastructure managers; the motion was seconded by MS. HARBO.

COMMISSIONER HULTBERG stated an interest in the opinions of the IAC on moving into this investment class and asked them to address the concern over whether or not this provides additional risk. DR. MITCHELL stated it's not an essential investment. DR. JENNINGS noted that a lot of these have inflation-adjusted cash flow streams, at least contractually, and they can always be renegotiated. COMMISSIONER BUTCHER stated approximately four percent of the Permanent Fund is invested in infrastructure, and he thinks it would be positive here, but not essential.

MR. BADER noted that he asked MR. WEISDORF if he was aware of any public entities that have reneged on their contracts, and MR. WEISDORF said he could not think of anybody that had reneged on the contract after it had been signed.

MR. BRICE asked, in terms of the field of investment managers, how large of a group of people is the Board looking at that participate in this type of business? MR. O'LEARY responded probably between ten and 20 firms.

MS. ERCHINGER inquired as to what impact, if any, there will be on internal staff and their ability to handle a new section of asset class and the managers associated with that, and also if there is a need to consider if any limitations should be placed on the types of investments. MR. BADER stated he does not think it will have any impact long-run, and he anticipates that this can be done with the existing staff without any impact on performance.

<u>Motion carried unanimously</u>.

11. CAPITAL MARKETS ASSUMPTIONS

MICHAEL O'LEARY of CALLAN ASSOCIATES, INC. gave a presentation on capital markets assumptions. *[A copy of this presentation is on file at the ARMB office.]*

MR. O'LEARY started with stating the objective for this meeting is to compare the assumptions from last year with those from this year and ask the questions: why are they different? And why should we think they're reasonable and then how are alternatives developed for the next board meeting? He noted that the alternatives should not be radical, unless that is a specific request by the board.

Referring to page four of the presentation, MR. O'LEARY reviewed the process of constructing capital market projections. He described the annual process of updating 10-year projections by evaluating the current environment and economic outlook, examining relations between economy and historical asset class performance, creating 10-year risk, return and correlation projections, and testing projections for reasonable results. MR. O'LEARY described the process as covering most broad asset classes and incorporates both advanced quantitative modeling as well as qualitative feedback and expertise at Callan.

MR. O'LEARY referenced a handout published by J.P. Morgan on long-term capital market return assumptions illustrating as a correlation estimate for each category against every other asset category. Using the example of the correlation between various types of hedge funds that the Board had discussed during earlier presentations, he noted that J.P. Morgan had a correlation estimate for each hedge fund category against every other asset category. MR. O'LEARY commented that the investment business is so dynamic that he questions if an event-driven hedge fund of today is like an event-driven hedge fund of ten or 12 years ago, but it provides a starting point to develop correlation estimates. MR. O'LEARY stated the three things to develop projections for: the central tendency of a long-term return, the magnitude of volatility around it, and its general way of reacting with other asset categories.

Moving on to Page 8, MR. O'LEARY described the three numbers making investors unhappy: bond yields in the low 2s, stocks below 8%, and 60/40 portfolio earning less than 7%. He stated that Callan remains optimistic about the economy, and while investors need to earn more, the challenge is to refrain from taking on more risk chasing higher returns. Fixed income allocations less than 10% are difficult to comprehend, but MR. O'LEARY strongly suggested that the Board maintain some fixed income exposure, with some flexibility on what that amount would be. He noted that the ARMB fixed income allocation is low relative to others.

MR. O'LEARY noted the five-year and ten-year return numbers on page 11 jumped up because the bear market at the beginning of the 2000s is out of the calculation, but the 15 year numbers are lower than the ten-year numbers. He described the Treasury Yield Curve over time graphically depicted on page 13, leading into a discussion of the U.S. economic outlook on page 14. MR. O'LEARY described the bad news and good news picture shown on the page concluding that for 2013 and beyond, continued modest growth is the most likely outcome.

MR. O'LEARY quickly reviewed slides depicting the slow rate of recovery from this recession compared to others, the slow employment growth, a rebound in household formation, which is necessary for a recovery in housing starts, inflation as a non-issue in 2012, and it should not be an issue in 2013, and the likelihood of the dollar depreciating against emerging markets' currencies.

Looking at U.S. economic growth by sector, MR. O'LEARY noted that GDP growth since 2006 has not averaged between two and four percent, once considered the normal growth, and 2013 might be two percent. He noted that the Fed Funds interest rate are presumed to stay near zero until 2015, waiting for unemployment to drop below 6.5%, but that there may be some increase in rates in 2014 in anticipation of the change in Fed policy. MR. O'LEARY stated that at the end of 2012, equities are close to what most would regard as fair value, so when Callan is developing estimates, the question is where is it coming from: dividend yields, valuations, price-to-book, price earnings, price-to-sales, etc.? The greatest increase in profitability in the U.S. has come from the manufacturing section, where you can get real productivity gains which flow through to profits.

Turning to page 45, MR. O'LEARY described the summary page for the Major Markets category illustrating the one-year arithmetic return, the ten-year geometric mean return with inflation subtracted to get the Callan estimate of inflation leading to an estimate of a real return with projected risk. The column on the right shows the same numbers for last year as a comparison, which shows that the expectation for nominal equity returns is slightly lower than last year because of the ten-year projection. Last year is over and out of the projection, so it's a moving ten-year target. He noted the 2.5% expected return for fixed income and cash earning 2% when it's earning 0.1% now; the explanation is the expectation that rates will go up, and if inflation is in the 2.5% range, the cash number is actually low.

MR. O'LEARY described the major asset categories as depicted on slide 47: 2013 Capital Market Expectations/Asset Mix Return and Risk – Includes Absolute Return & Equity Subclasses. He stated that for these asset categories with no constraints, the optimizer will give the best mix, which is all of them given those assumptions and presuming a projected arithmetic return of 5% to 7.75%, with a ten-year mean return of 4.91% to 6.92%. The mantra is the higher the volatility, the greater the difference between the arithmetic mean and the geometric mean. Moving to the next slide, MR. O'LEARY noted this looks similar, but isn't because absolute return is excluded, and another mix has been added and moved further out on the efficient frontier at 16.55% while the S&P 500 has a long-term average standard deviation of about 15%. The ARMB current policy is near Mix 5, over 14%.

MR. O'LEARY next referred to a secondary handout, *[available at the ARMB office]* Supplemental Asset Allocation Information, depicting estimates for each of the unique asset categories, ARMB fixed and ARMB real. The components of the ARMB Fixed portfolio are together in a mix similar to how the assets are allocated to come up with an estimate. The optimizer is unable to use this information in its analysis, so these are calculated. Slides 3 and 4 show the Risk and Return Assumptions and the correlations associated, and Slide 5 is a graphical depiction of risk/reward of each asset class. MR. O'LEARY then compared the ARMB current policy with asset mix alternatives and an illustration of the current policy range of returns over one, five and 10 year periods. He noted that most of the risk reduction occurs in the five-year, but even more going out ten years which is where the focus is.

MR. O'LEARY then stated that the next step in light of board actions taken earlier in the day will be to come up with an estimate for the "Other Equity" category which will have several components to it, which will be done in conjunction with staff and the advisors. Following that process, a more elaborate comparison of alternatives will be presented to the board and recommended by staff at the next meeting.

Moving next to the presentation, *Defined Contribution Trends: Real Return Risks and Opportunities [available at the ARMB office],* MR. O'LEARY noted the importance of the defined contribution programs and that ARMB has always been on the leading edge of public arena individual account programs, but there is a lot of activity in this arena with discussion of modification of target date funds, real return, absolute return etc. and what are best practices today. He asked PAUL ERLENDSON to provide insight for the board into this area.

MR. ERLENDSON stated the point of this presentation is that we are in the early stages of the marketplace, trying to figure out how to give participant-directed plans the ability to hedge against inflation. He noted buying TIPS, Treasury Inflation Protected Securities, is an incredibly expensive solution, but it can be done within target date funds which provide some insulation for some of the technical challenges of offering TIPS as a standalone option. Callan hasn't seen inflation as a problem, but there is broad expectation inflation will return, and the challenge for this group is to give the participant-directed plan membership an ability to hedge against that risk in future.

MR. BADER questioned what would happen if a person doesn't want to be in a target date fund. MR. O'LEARY stated one of the big issues the committee has to think about is there are very few programs that have the range of investment choices that are available to ARMB participants and that that sort of structure sometimes confuses participants because it provides them with too many choices. Some plans have offered international bond funds, infrastructure, real assets, so it's worth the time to study these issues, even if you don't change anything about your plan.

MR. ERLENDSON stated, in terms of the participant choosing an individual option on their own, the guiding principle is first do no harm, so looking at the volatility of commodities or some other options, it is easy for a participant to get significantly hurt. We want to make sure when something is added to the platform all issues are understood first and since inflation is not taking off immediately, there is time to do it right. .

MS. ERCHINGER asked if the Board need another conversation about changing its earnings assumption and also asked if it is important to have that conversation and to consider changing the earnings assumption. MR. O'LEARY stated the answer varies by situation, but in the ARMB's case, the thing that is worrisome is that it's a limited pool of participants who are members in the DB program. He stated the good news is that unanticipated increases in liability become less likely because it is that finite pool. In a young, rapidly growing plan situation, the Board can be pretty aggressive in the investment because future contributions are a bigger deal. He noted the different investment periods since World War II can illustrate 10-year periods where a prudent blend of stocks and bonds didn't produce a meaningful real rate of return.

MS. HARBO stated the Board has to pay attention to the long-term noting her experience in personal investments of a 30-year period. MR. O'LEARY shared the view that the Board does not want to be switching around contribution rates on a very short-term basis because it's measuring long-term inflation, long-term liquidity needs and the gap between the sensitivity of liabilities to inflation and sensitivity of investments to inflation.

MR. ERLENDSON noted philosophically, as a society, do we want to provide retirement benefits, and discussed the Defined Benefit versus Defined Contribution scenarios.

MR. PIHL noted the unfunded liability should be taken care of it by 2032 during this closed period. MR. PIHL stated he would like the ARMB to ask Buck to run the numbers at seven as well as eight. MR. BARNHILL noted Buck changed the structure of the valuation, and they began running stress tests on the different interest rates. MR. BARNHILL noted he is not aware of a 60-year projection. MR. PIHL stated he is not looking for 60-year projections, only for 25-year projections, and on the 25-year basis, he would like to see the numbers at seven and eight.

MS. ERCHINGER stated ARMB is in a closed system that is going to require a lot of liquidity in the coming years. Over the next 25 or 30 years, what the Board is dealing with today in terms of its assumptions, the Board should consider whether it will be valid over the long haul and that how it relates to interest earnings assumption. MR. O'LEARY stated it will be an important issue to study and understand. The things to be considered are the known outflows and how they relate to the size of the corpus.

MR. BADER noted MS. ERCHINGER is suggesting similar work that Karen Harris of Callan has done for the Board in the past. MR. O'LEARY stated it's an asset liability study. MR. BADER noted it has been approximately five years since the study has been done, and it would address MS. ERCHINGER's concerns in terms of private equity. MR. BADER noted MS. HARRIS could do that study.

MR. PIHL pointed out the Board has big numbers, $143 billion for the Defined Benefit system, $143 billion to meet over time, and in the early '30s, that outflow is going to be $2.5 billion or in excess of $2.5 billion a year just on the DB system, the current DB system.

MR. BARNHILL stated the sensitivity analysis is set forth on page 49 of the valuation for PERS, and if Board members want to see something different displayed in this year's valuation, to let him know. It's the FY11 valuation. MR. BARNHILL noted he will send a link to JUDY HALL, and she can distribute the link.

MR. TRIVETTE would look to CALLAN for data regarding reevaluating equity or other pots of money the Board has that are long-term, and deciding at what point in time the Board should liquidate to have the money available. Since rate of return is based upon, what the Board has in its investment policy, the Board also needs to look at that.

MR. BRICE noted that, in tomorrow's meeting (2/13/13), in "New Business," he plans on introducing a resolution for consideration by the Board to reiterate some of the things the Board has said in the past about the unfunded liability. The packets were distributed to the Board members.

RECESS FOR THE DAY

CHAIR SCHUBERT recessed the meeting at 4:12 p.m.

Wednesday, February 13, 2013

CALL BACK TO ORDER

VICE CHAIR TRIVETTE reconvened the meeting at 8:58 a.m.

REPORTS (continued)

12. MONDRIAN INVESTMENT PARTNERS (US) INC.

GARY BADER introduced JUSTIN RICHARDS and DAN PHILPS of Mondrian Investment PArtners (US), Inc. *[A copy of this presentation is on file at the ARMB office.]*

MR. RICHARDS gave a presentation on Mondrian's international fixed income portfolio for the ARMB, focusing on the year 2012, performance, how the portfolio is positioned, and the outlook on the portfolio. Mondrian is a value-oriented manager, running just over $68 billion U.S.

MR. PHILPS noted page 2.2 is the most important page in the Mondrian presentation book, to understand how Mondrian invests in global fixed income and on ARMB's portfolio at Mondrian, and about maximizing the Board portfolio's exposure to the markets to generate the strongest future real income streams.

MR. PHILPS noted Mondrian uses the PRY, prospective real yield, the ten-year government bond yield in a market, minus future inflation. In other words, the inflation forecast.

MR. PHILPS gave an overview of the "Performance" section of the book, for how the markets performed over the last 12 months, ending December 31, 2012, positioning, and how that positioning was all driven by the prospective real yield. The strongest performing market was Poland, representing a 26.6% total return in U.S. dollar terms. There was an overweight position in Poland and that was beneficial to the performance of the fund; Poland is a relatively strong prospective real yield market. Mexico was also a strong performer in 2012 with a 21% return over the year; we were also overweight in Mexico. In the main three currency blocks, the U.S., Japan, and the Eurozone, performance was relatively mixed. The U.S. and Japan were the weakest performing developed markets, Japan the weakest of all. The strongest emerging market performer in our universe over 2012 was Hungary with a very strong 33.9% total return denominated in U.S. dollars. China and India have been very underweight, and China was the weakest performing market over the course of 2012.

MR. PHILPS noted the total return on the portfolio was 6.2% over 2012, a very decent absolute return versus 5.4% of the benchmark, which generated an excess return of 0.8% over the year. He noted that return is in excess of what ARMB's portfolio would have generated, had the Board stuck with a pure developed market, international fixed income. MR. PHILPS also stated the key characteristic of the prospective real yield approach is that it generates consistent and strong long run returns.

MR. BADER asked how what benchmark is used in calculating the prospective real yield. MR. PHILPS stated the prospective real yield is calculated using the ten-year government bond yield, minus future inflation.

MR. BRICE asked for remarks on Israel. MR. PHILPS noted a strong prospective real yield in Israel will translate into a stronger real income stream over the medium to long-term.

MR. O'LEARY asked MR. PHILPS to give the Board some prospective on the extent to which Mondrian hedges because it appears that there are no current hedges. MR. PHILPS replied Hedging is a defensive part of Mondrian's process. What Mondrian seeks to do with its hedging and purchasing power parity is really to have a sense check of prospective real yield.

DR. MITCHELL asked MR. PHILPS to discuss Japan in greater detail. MR. PHILPS stated Mondrian sees continuing, underlying deflation in Japan, and deflation is additive to real yield.

MR. BRICE asked if Germany is incorporated in Eurozone and why Mondrian didn't break that out individually. MR. PHILPS replied the prospective real yield Mondrian calculates in the Eurozone is based on the German ten-year government bond yield. The prospective real yield is very poor in the Eurozone; all allocation is in Germany.

MR. BRICE asked if it's Mondrian's contention that the Eurozone will dissolve. MR. PHILPS stated there is a big difference between re-domination, a break up of the Eurozone, and an individual state being unsustainable.

MS. HARBO asked for comments on Czechoslovakia. MR. PHILPS stated the Czech Republic has been in an area of opportunity for Mondrian over the last 18 months. The prospective real yield there was relatively strong. It's an exception state into the Eurozone.

MR. TRIVETTE stated it would be beneficial in Mondrian's next presentation to the Board if they will provide a chart showing how much money ARMB put into Mondrian to start with, how much money has Mondrian given back to ARMB since inception, and if ARMB has given Mondrian additional money since 1997.

DR. MITCHELL inquired about how much of the prospective real yield from the fixed income side works its way into Mondrian's equity strategy. MR. PHILPS stated the inflation forecasts that Mondrian uses per market are actually used in its dividend discounting models used on the equity side.

MR. ERLENDSON asked for Mondrian's level of confidence in ability to predict the inflation rates over the next ten years and what it is doing to address that. MR. PHILPS stated Mondrian is focused on the real economy.

MR. O'LEARY asked MR. PHILPS to refresh the Board's memory as to Mondrian's style. MR. PHILPS stated Mondrian is relatively low turnover. He noted it is all about maximizing prospective real yield with regard to risk.

13. ARMB FIXED INCOME PORTFOLIO

Senior Investment Officer, BOB MITCHELL, gave a presentation titled Domestic Fixed Income, which discussed three mandates that internal staff managed on the ARMB Board's behalf, located in three different asset classes. *[A copy of this presentation is on file at the ARMB office.]*

MR. MITCHELL illustrated the actual asset allocation of the ARMB Board as of December 31, 2012. The fixed income portfolio group manages a TIPS mandate in the real asset class, the short-term fixed income mandate, and a large component of the fixed income mandate.

MR. MITCHELL noted the size of the TIPS portfolio is about $200 million, the size of the short-term fixed income, as of December 31, 2012, is about $600 million, and the size of the intermediate treasury component of the fixed income portfolio was about $1.9 billion, and the intermediate treasury portfolio is now a little more than $1.7 billion in size.

MR. MITCHELL stated their investment approach is to structure portfolios relative to the underlying benchmarks that they believe will have positive relative performance over a variety of different potential future outcomes; the time horizon for those scenarios is one to three months. MR. O'LEARY asked MR. MITCHELL to give the Board some sense as to the duration of the short-term portfolio. MR. MITCHELL stated the benchmark for that portfolio is a three-month T-Bill.

MR. MITCHELL noted another measure of interest rate sensitivity they look at is spread duration, with a spread duration of about 0.4 years. MR. MITCHELL stated about three-quarters of the intermediate treasury portfolio is in treasuries or short-term fixed income.

MR. MITCHELL stated, in terms of investment guidelines, they have a constraint that the portfolios can have no more than 30% of non-treasury, non-short-term fixed income assets in the portfolio. They are about five percentage points under that threshold. He pointed out that, for the TIPS portfolio, the real duration measure describes the sensitivity of the market value of the portfolio to changes in real interest rates. The real duration refers to the fact that TIPS trade on a real yield basis, and the pricing of TIPS is sensitive to changes in real interest rates along the curve.

MR. O'LEARY asked MR. MITCHELL to describe what the calculation is for the term real yield. MR. MITCHELL explained there is a separation here, where the coupon is the same, but it's paid on a growing principal balance as inflation accrues to the par amount. He also highlighted that TIPS are a much smaller component of the bond market than treasuries or other securities, and at times, can trade with very little liquidity and can behave in ways that can be surprising because of that lack of liquidity.

MR. MITCHELL discussed the short-term fixed income portfolio. The benchmark for this portfolio is a three-month treasury bill. The portfolio has about 40% of its assets in treasuries. About 95% of the portfolio is in securities that are rated AA+ or higher.

MR. MITCHELL stated, for a period of time, they were selling TIPS in an illiquid market and that caused a period of underperformance. With the passage of time, he reports they've come out of that negative performance, relative performance and now have positive since-inception performance in that portfolio.

MR. MITCHELL noted the presentation demonstrates interest rates are at the low end of their 40-year range. With front end rates at zero and the ten-year at slightly above two percent, the index for the intermediate treasury portfolio has a yield that's about 60 basis points for almost four years of duration. Yields are pretty low. He also noted real yields for the ten-year TIPS since inception in the United States in 1997 and highlighted they are in negative yield territory, another indicator that yields are low.

MR. MITCHELL stated the takeaway is, despite the fact that yields are low, relative demand is probably going to be pretty high, and a significant part of that demand is the Federal Reserve.

CHAIR TRIVETTE asked if MR. MITCHELL thinks it is one, two, or three years out. MR. MITCHELL stated this is for the calendar year 2013.

MR. MITCHELL pointed out another prominent dynamic in the markets is that retail investors, mutual fund investors have been investing in bonds at the expense of equity since the crisis, and the first takeaway is the markets are very much impacted by policy decisions. The other takeaway is understanding what the psychology of the markets is. With the advent of ETFs, that is another significant growth part of the markets, and it's a way to quickly get exposure or to take exposure off.

MR. O'LEARY stated, in looking at the estimated supply, his impression is that corporate treasurers have been very aggressive in issuing bonds, and the value of that seems to be greater than the pace suggested by these numbers. He asked if that is because they're refunding other bonds and only looking at the net increase. MR. MITCHELL noted, when looking at 2012, we've had the most high yield supply ever in that year. However, the net supply was zero or it might have been slightly negative because a lot of that activity was refinancing call bonds or tendering for bonds and extending maturities. So the net of all that activity was a lot less pronounced than the gross numbers would imply, and these are net estimates. With rates where they are, there is an incentive for everyone to issue.

MR. O'LEARY stated bank loans have become a hot investment topic because it's a short duration, high yielding alternative, and in a recent Morgan publication, that there was a slight tick up in delinquency on bank loans. He inquired where those types of things surface in the bond market and asked if it is through collateralized loan obligations. MR. MITCHELL stated he is not as familiar with it, but would say that, based on his conversations with MacKay Shields, they look at it and say yes. He stated he would say bank loans would probably be a market that would probably give a whiff of increasing stress in the bond market. And basically, all bank loans and would behave similarly.

MR. PIHL asked if the Federal Reserve purchases mostly treasuries, and if that's the case, is that a rollover of the treasuries. If that is the case, he asked if the Federal Reserve is buying securities up at a higher interest rate than the ones going out, and therefore, having an impact on the rate environment. MR. MITCHELL replied the current program is to purchase treasuries and mortgages, but yes; there have been previous quantitative easing measures that have focused strictly on treasuries.

MR. BADER asked MR. MITCHELL to comment on the Board's exposure to collateralized mortgages. MR. MITCHELL stated it's pretty modest.

MR. ERLENDSON asked, given the circumstances that MR. MITCHELL outlined, if there are any guideline revisions/updates that he is contemplating bringing forward. MR. MITCHELL stated no; he is not.

MS. ERCHINGER noted the presentations today made her question the overall allocation that the ARMB Board has to fixed income, currently, an allocation of 14% overall, and looking at what portion of that fixed income is allocated to domestic fixed income, $1.7 billion of the approximately $3 billion that is allocated to fixed income is domestic. She asked the question, why does the Board have such a high allocation to domestic fixed income?

MS. ERCHINGER would be interested in asking the IAC to have a conversation. She would like to see a conversation around the issue of redistributing the Board's allocation of fixed income out of domestic and more into international or some other diversified assets that give more comfort that can be stretched for yield, but in a prudent fashion. She noted, at the April meeting, the Board will be talking about asset allocation, and she would like the Board to consider whether it should make a meaningful change in this regard and that would then lend itself to a question to MR. O'LEARY, when he is giving scenarios for asset mixes, whether it's too much to ask to throw some asset mix calculations before the Board that make a meaningful departure out of domestic fixed income. She also noted the Board is not going to reach its return assumptions with any of the asset mixes and so knowing that, the Board needs to make some changes. CHAIR TRIVETTE stated that is something the Board can ask the IAC, Callan, and Mr. Bader and his staff to put on the agenda for the April meeting.

CHAIR TRIVETTE recessed meeting from 10:11 a.m. to 10:24 a.m.

14. (*REMINDER: Agenda Item 14 was moved after Item 10.*)

NEW BUSINESS

CHAIR TRIVETTE called the meeting back to order and noted a request from COMMISSIONER BUTCHER to move into New Business at this time and come back to Unfinished Business later in the agenda. There were no objections from Trustees.

MR. BRICE noted he passed out an untitled resolution for discussion.

MR. BRICE moved the resolution for purposes of discussion; the motion was seconded by MS. RYAN.

MR. BRICE stated the resolution is to have the ARMB Board reaffirm the past resolution requesting the Administration and the Legislature to pursue an avenue to set up a plan, and over the next four sessions, $500 million to each of the two Boards, primarily the PERS and TRS Boards, for addressing the unfunded liability. The purpose behind the resolution is the ARMB Board can invest in a more aggressive manner than the State can, and every dollar that the Board put towards the unfunded liability today saves a dollar plus "X" out into the future.

MR. PIHL noted, at the April meeting, the Board will get the actuary report, which will be on level dollar, which is going to introduce a lot of new numbers to the equation, and that was a major effort and accomplishment by the ARMB Board to make that step. MR. PIHL also stated that he thinks what the Board wants to do is confirm or restate or reaffirm the resolution that it passed last February, where the understanding was there was going to be $500 million proposed to go, in addition to the state assistance. He also noted, with respect to this resolution, he would suggest wording changes in the third "whereas." On the end of the first line, it says "the annual amount." He would like it to read "the annual amount of state assistance." And later on in the line, it should say "will soon exceed $1 billion."

MR. BRICE stated that's a friendly amendment; there was no objection by Trustees.

MR. PIHL also noted the Legislature appears to be very interested in the ARMB Board's input and position with respect to the unfunded liability.

COMMISSIONER BUTCHER stated he has concerns that the Legislature is interested in hearing what the ARMB Board has to say and that the Board needs to come up with a comprehensive plan to the Legislature. He noted the Governor asked the Board, last year, to consider options, and he is concerned that the Board hasn't fully vetted what would be the position of the Board going to the Legislature as opposed to just this particular plan being considered by the Board. He also expressed concern as to how it would be accepted in Juneau.

COMMISSIONER HULTBERG stated the resolution was in December of 2011, and it had multiple scenarios. Then the Board looked at all those scenarios and identified six scenarios that it recommended the Legislature and the Governor consider further.

CHAIR TRIVETTE noted there were two separate resolutions, one in December and an additional one in the February meeting in Juneau.

MR. PIHL said, to his recollection, there was one resolution, and he thought there was a resolution that, when the Board understood there was $500 million being put in the budget, it passed a resolution supporting that.

MS. ERCHINGER stated she did a chronology of events summarized as follows:

- Starting with the Governor's visit to the ARMB Board on September 21, 2011, followed by two resolutions passed by the ARMB Board. One was at the meeting of December 3, 2010 where Resolution 2010-31 was passed, changing the Board's Investment Real Return Assumption, and there was a second resolution that followed that did the same thing, but one was for PERS, one was for TRS. That was Resolution 2011-01, February 2011.

- Next, the Board convened a two-day meeting in Juneau to talk about the unfunded liability and whether the Board had some consensus around how to address that. That followed with an ARMB Board resolution passed December 1, 2011, where the Board articulated the scenarios that were being recommending to the Legislature. That is in Resolution 2011-23.

- MR. PIHL attended the Senate Finance Committee at their request, on January 11, 2012, to discuss the Board's findings from those recommendations. Then the Board passed a resolution in June of 2012 and that was changing the amortization methodology from level percentage of pay to level dollar, Resolution 2012-19.

- The ARMB Legislative Committee met on September 19, 2012, and the Board subsequently passed a resolution.

- Finally, the Board passed Resolution 2012-02 on February 17, 2012, regarding the Reserve Fund concept.

COMMISSIONER BUTCHER pointed out, for the benefit of the new trustees, approximately a third of the Legislature is new this year. COMMISSIONER HULTBERG recommended that the Board go back to the six scenarios, refresh the scenarios, and then have the conversation starting from that point.

MR. BARNHILL stated the only resolution that stated an amount was the one from December 2011 identifying the six scenarios. Scenario D called for a $1 billion appropriation with continued state assistance under a level percentage of pay. Scenario J called for a $1 billion appropriation with continued state assistance under level dollar amortization. None of the scenarios called for a $1 billion appropriation over a four-year period. The resolution before the Board today is a brand new scenario that has not been modeled. There were various things that were modeled, but the $4 billion appropriation was not modeled.

MS. ERCHINGER stated she thinks there needs to be a plan around how is it that this group of trustees can most effectively work with members of Legislature and the members of the Administration to formulate a solution.

MR. BARNHILL stated there were some scenarios where the Board considered an appropriation of $6.15 billion into the trusts with no further state assistance, coupled with no state assistance which meant that amortization was not finished until 20 years later, and the Board rejected those scenarios.

CHAIR TRIVETTE stated the Board looked at 40 or 50 scenarios several years ago, so this draft resolution, even as amended, is not out of the ordinary or something that hasn't been discussed.

COMMISSIONER HULTBERG stated it's important to be able to see the impact of the scenarios and to compare them side-by-side and that's the piece the Board does not have available to make this decision. She also noted this Board, the Administration, and the Legislature have been very responsible in making the actuarially required contributions to the system.

MR. PIHL noted the first suggestion of $500 million additional funding occurred by Governor Murkowski in the proposed budget he left when he left office. He thinks we need to do something that brings a message to the current Legislature, so he proposed the following change of wording: in the third line after "allocate," the words, "In addition to state assistance in the next four years, $500 million towards retirement of the unfunded liability of the Alaska Public Employees and Alaska Teachers Employees Retirement Systems." By doing that, it's not stepping up the amount from $500 million to a billion, but the Board is suggesting and reaffirming what we did before. MR. PIHL stated it should be followed by a presentation to a joint committee of the Legislature of this resolution, along with the background of all these steps that the ARMB Board has taken in its prudence.

MR. BRICE inquired as to whether it would be $500 million to each of the two systems, and MR. PIHL stated no, and his wording was that would be in addition to the state assistance, $500 million towards retirement of the unfunded liability of both systems.

MS. ERCHINGER stated, for the record, it's fair to say that the Board did run the scenario of the $500 million per year. While she supports the resolution, she feels it is inappropriate it was brought forward on day two and that it lends itself to the Board being asked to make a decision for which it has less information that the Board is comfortable having.

<u>MS. ERCHINGER moved to postpone action on this resolution to the meeting in April</u>; <u>the motion was seconded by MS. HARBO</u>.

MS. RYAN made a point of order and inquired if the Board had another motion on the floor concerning the changes. CHAIR TRIVETTE said no.

CHAIR TRIVETTE stated there was no other motion on the floor, except the resolution, but there was a motion on the table to table this resolution until the April meeting and that was non-debatable. MR. JOHNSON stated that is correct. MR. BRICE objected.

CHAIR TRIVETTE called at at-ease from 11:02 a.m. to 11:03 a.m. for MR. JOHNSON to review Robert's Rules.

CHAIR TRIVETTE called the meeting back to order, and MR. JOHNSON stated he had done research, and the answer to the question is in Section XIV in Robert's Rules and that does provide that that motion is debatable. It is distinguishable from a motion to table, just later in the day, which is not debatable, but it was for a specific time.

CHAIR TRIVETTE stated the motion to table was on the floor and open for debate.

MR. BRICE brought to the Trustees' attention that he addressed this at the December meeting in Anchorage under Trustee Remarks. He very specifically said that he would be bringing forth a resolution to address unfunded liabilities of the Board, and he gave his notice at that stage.

MS. RYAN expressed her primary concern is, if the Board postpone the motion to April, it misses this session. She stated she is for the motion to table to look it, but also against the motion.

COMMISSIONER HULTBERG acknowledged MR. BRICE's comments at the December meeting, but because the Board has not run the models, she believes the Board is putting itself in a position where it's voting on a specific scenario without having the benefit of the actuarial analysis of that scenario, and she is very uncomfortable with that. MR. BRICE noted he does not see a scenario where, under any actuarial model, this would increase the liability.

MS. ERCHINGER stated her hope is that the Legislative Committee will meet no later than March 15th to address this resolution and come up with a solution to trying to, at least, get people at the same table before the Board votes on the resolution. That is the reason she supports postponement, in the hope it will be the impetus to get people to sit down and talk.

MR. BRICE stated he sees calls for instate gas lines, for substantial bridges and infrastructure this state desperately needs, and for a real desire by this Governor and this Legislature to review our oil taxation system. He believes he is the only one that has brought up liability on a consistent basis.

COMMISSIONER HULTBERG confirmed her concern is the demand on the cash flow from the General Fund. She is concerned it undermines the credibility of the Board to advance a resolution without having done the work. MR. BRICE stated it addresses the cash flow issues of the state by ensuring that the calls on the state General Fund in the future will be substantially less. He also noted there are a number of calls on those reserves, and the more that the Board does now the less of a call will be had on the General Fund in 2032.

TRUSTEE RYAN requested the motion as stated before it was moved to table, to hear it as modified. CHAIR TRIVETTE re-read the changes. On the third "whereas" at the end of the first sentence, "The annual amount of state assistance." "Of state assistance" is part of the amendment. The next line down where it says "will soon be," the "be" was changed to be "exceed." On the last paragraph, "Now, therefore, be it resolved," and it says, "Now the Governor to allocate," and the change is "in addition to state assistance" and then after "the sum of $500 million toward the unfunded liability was added."

CHAIR TRIVETTE asked for there additional debate on the motion to table; there was none.

ROLL CALL was done by JUDY HALL. The motion to table was tied, four in favor and four opposed, and MR. JOHNSON stated the motion fails.

CHAIR TRIVETTE made a motion to table to a Special Meeting of the Board between now and the April board meeting, the first week of April, to try to do something before the Legislature ends this session. MR. BRICE stated his intent to pass the resolution at today's meeting because the issue is the Legislature adjourns April 15th. COMMISSIONER HULTBERG stated she cannot commit the actuary, but believe the Board could have these numbers run in a period of a couple of weeks. COMMISSIONER BUTCHER noted the Department of Revenue comes out with its spring revenue forecast the first couple of days of April, and the last-second spending decisions aren't made for the end of session until they have that updated information.

CHAIR TRIVETTE proposes to have the meeting sometime between now and the April board meeting, probably at a time before the end of March. TRUSTEE PIHL proposes another friendly amendment to wording, and CHAIR TRIVETTE accepts that as the final wording of the motion.

MS. RYAN recommended the Board needs to have a policy that documents are in writing to the Board ahead of time to look at, given to the Board at one meeting and voted on at the next meeting. She stated she feels this is one of the most important things the Board has voted on, and she feels very uncomfortable about the wordsmithing that has gone on, without being able to see exactly what she is voting on.

CHAIR TRIVETTE moved to table this motion to a time certain, which time shall be before the end of March 2014 for a Special Meeting of the Board; MS. RYAN seconded the motion.

COMMISSIONER BUTCHER expressed his approval.

The motion passed.

MS. ERCHINGER expressed her hope that the primary outcome of this delay will be that the Board can possibly amend the resolution further, at the approval of the Board, to tell the Legislature what the impact is of this decision.

CHAIR TRIVETTE stated the Board is not going to set dates at this time. The motion to table has passed and that takes the Board through new business in terms of that resolution. With no objection, the Board reverted back to Unfinished Business.

UNFINISHED BUSINESS

1. Disclosure Reports

MS. HALL stated that the disclosure report was included in the packet.

2. Meeting schedule

MS. HALL reported the following additions to the calendar: 1) October 3 and 4, 2013, for the Education Conference.

3. Legal Report - Executive Session

MR. BADER stated he would like the Board to make a motion to go into Executive Session to hear advice on strategies from legal counsel.

MR. BRICE moved to go into Executive Session to receive advice from legal counsel; MS. RYAN seconded the motion.

CHAIR TRIVETTE noted there was no objection to the motion, and the Board will go off record at 11:52 to 12:27 to go into Executive Session.

CHAIR TRIVETTE calls the meeting back to order and notes the Board is out of Executive Session.

MS. HARBO moved the Board accept the recommendation of the Attorney General's office; MS. RYAN seconded the motion.

The motion passes unanimously.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD

None

PUBLIC/MEMBER COMMENTS

None

INVESTMENT ADVISORY COUNCIL COMMENTS

None

TRUSTEE COMMENTS

MR. BRICE expressed his appreciation for the open and candid conversations about how the Board operates and stated it's something for ARMB Board consideration in the future.

MS. HARBO thanked the Retirement Benefits Division for the excellent and informative healthcare newsletter.

MS. ERCHINGER thanked the Division of Retirement and Benefits for significant improvements in the website and also thanked Judy Hall for all her good work that's been done to put information on the website.

MS. ERCHINGER would like to see the Legislative Committee meet to talk more about some of the issues that were addressed today, but also to come to a consensus as to a possible presentation to the Legislature. She suggested a letter to the Legislature that articulates the steps that the ARMB Board has taken in the last two years to reduce the unfunded liability.

MS. ERCHINGER requested more robust Meeting Minutes included in future packets so that some of the more important dialogues are captured. She also offered an apology to Bob Mitchell for her comments following his presentation, noting that he and his team do a great job with the market conditions, and that is no reflection on them.

CHAIR TRIVETTE stated a need to develop a process where Minutes come to the members of the committee before the next regular ARMB Board meeting and suggested the issue of Minutes needs to be done in a planning session. He stated, at the April meeting, he will make a recommendation and ask for a work session later in this year to look at some of these issues.

FUTURE AGENDA ITEMS

MR. PIHL stated interest assumption needs to be the Board's continuing thought.

COMMISSIONER HULTBERG suggested considering, at a future planning meeting, the Board have a fairly regular calendar or sequence of events that occurs, timing on when the Board receives reports, when they go to the Board, when the Board makes decisions, so recommendations are ready by the meeting and so that they are done prior to session.

MR. PIHL would like to add GASB 67 and 68, to the extent that they address the unfunded liability and how it's going to be addressed over time, on the future agenda items.

MS. ERCHINGER stated she has been working with Mr. Barnhill on a resolution that will be ready for the April meeting to address the allocation of administrative expenses as it relates to actuarial costs.

COMMISSIONER RODELL reminded the Trustees that work had started on revising the handbook, and it will be brought to the Board at some point during 2013.

COMMISSIONER HULTBERG made a data request to get a breakdown of management fees to understand, over time, what the impact of those management fees has been and to understand the cumulative impact of those. After some discussion of active management fees in liquid versus illiquid assets, MR. BADER stated that providing the active fees would be relatively simple, but he would check with accounting for the closed-end real estate funds.

ADJOURNMENT

There being no objection and no further business to come before the Board, the meeting was adjourned at 12:45 p.m., on a motion by made MS. RYAN and seconded by COMMISSIONER HULTBERG.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Gayle Harbo
Secretary