State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location:
Centennial Hall
Egan Room
Juneau, Alaska

MINUTES OF
April 18-19, 2013

Wednesday, April 18, 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
Commissioner Bryan Butcher
Martin Pihl
Tom Brice
Sandi Ryan

Board Members Absent
None

Investment Advisory Council Members Present
Dr. William Jennings

Investment Advisory Council Members Absent
Dr. Jerrold Mitchell
George Wilson

Department of Revenue Staff Present
Angela Rodell, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Pamela Leary, State Comptroller
Bob Mitchell, State Investment Officer
Zachary Hanna, State Investment Officer
Emily Peyton, Assistant Investment Officer
Kayla Wisner, Department of Revenue staff
Tim Shockley, Department of Revenue staff
Sharon Gill, Department of Revenue staff
Michelle Vuille, Department of Revenue staff
Judy Hall, Board Liaison

Department of Revenue Staff Absent
Steve Sikes, State Investment Officer
Scott Jones, Assistant State Comptroller

Department of Administration Staff Present
Mike Barnhill, Deputy Commissioner
Jim Puckett, Director, Division of Retirement & Benefits
Lee Hullinger, CFO, 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.
Leslie Thompson, Gabriel Roeder Smith
Dana Woolfrey, Gabriel Roeder Smith & Company
David Slishinsky, Buck Consultants
Chris Hulla, Buck Consultants
Lee James, Buck Consultants
Monica DeGraff, Buck Consultants
Gail Levenson, Buck Consultants
Bob Ferraro, Buck Consultants
Chris Cook, Guggenheim Investments
James Pass, Guggenheim Investments
Joseph Carieri, Western Asset Management
Robert Amodeo, Western Asset Management
Lisa Tyrrell, State Street

PUBLIC MEETING NOTICE

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

APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda. VICE-CHAIR TRIVETTE seconded the motion. MR. PIHL noted that the Board may need more than one hour to review the Buck presentations. With that note, the agenda was approved.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

None.

APPROVAL OF MINUTES

MR. BRICE moved to approve the minutes of the February 12-13, 2013 and March 15, 2013 meetings as presented. MR. PIHL seconded the motion.

VICE-CHAIR TRIVETTE made note of several corrections:

> Page 6: A word was left out where Ms. Harbo inquired about the progress on the actuarial audit; Ms. Harbo referred specifically to the replication audit.
>
> Page 15, third to the last line: should have said "every other asset category".
>
> Page 20, Line 1: "along with the Chair" is not necessary since all present were listed.

The minutes were approved as revised.

REPORTS

1. CHAIR REPORT

CHAIR SCHUBERT reported that they had sent the letter to the legislature on the funding request as requested by the Board, and that she testified before the Senate Finance Committee on the funding request. The letter, testimony, and supplements were also sent to the Legislative Committee.

2. COMMITTEE REPORTS

CHAIR SCHUBERT reported that the only committee that had met was the Legislative Committee, which met on April 17 and discussed actuarial services. The Legislative Committee decided that the full Board should have a work session with the actuary, and they are planning to schedule that when time permits. They also decided to start the planning process for legislative requests earlier this year, and are working to schedule a June meeting for that purpose.

MS. ERCHINGER requested that the Board make sure to discuss, as previously requested, the relationship between the Board and the actuaries, and the role of the Board, if any, in hiring the actuaries. VICE-CHAIR TRIVETTE noted that they had discussed on the previous day needing to review with ROBERT JOHNSON the statute about who has what responsibilities.

3. RETIREMENT & BENEFITS DIVISION REPORT

MR. PUCKETT introduced the new CFO, LEE HULLINGER. MR. HULLINGER and his family moved from Salem, Oregon, where he recently served as CFO of Healthcare of Oregon and previously was CFO of Oregon State Hospital.

A. Legislative Update

MR. PUCKETT gave a legislative update, saving the bill of greatest interest to the ARM Board for COMMISSIONER HULTBERG to discuss.

- There were two companion bills dealing with pharmacy audits, which would have had minimal impact on the retiree health plan; one of them got into committee and has sat there since then.

- SB 30, the defined benefit/defined contribution choice, got into the State Affairs Committee, then did not move.

- SB 65, an update to Alaska trust law which would have had minimal impact to the Division, passed through the legislature and was sent to the Governor. This bill will strengthen current statutes that already protect retirement assets from assignment by creditors. MR. PUCKETT stated that they will do internal review of the processes of disbursing money to beneficiaries to make sure they are compliant with the changes in this bill.

- HB 116, which will allow police officers and firefighters to use some of their military service to purchase eligibility for retiree health plans, will also have minimal impact to the Division; MR. PUCKETT did not specify its disposition, but stated that the indebtedness created by it would be paid by the member.

- HB 124 would have changed the retiree health plan to offer coverage for dependents up to age 26, adding a cost of $159 per member per month. It got into the House State Affairs Committee, and hasn’t moved since.

- HB 152, which would have changed the method by which termination costs are calculated, got into one committee and hasn’t moved in the past session.

- Companion bills HB 174 and SB 48 would exempt three communities, which had a drop of 25 percent or more in their populations between 2000 and 2010, from the 2008 salary floor. It made it to a second committee, but hasn't moved from there.

COMMISSIONER HULTBERG gave a briefing on SB 90 and companion bill HB 196, which would have rolled all school district employees into the Department's active health plan, adding about 47,000 new members to the existing 16,400. This bill would result in cost savings for many, but not all, school districts, but it was introduced very late in the session, when there was only about a month left. COMMISSIONER HULTBERG stated that this insurance pooling has several significant benefits, such as the ability to lower administrative costs by achieving scale, which also leads to better negotiating ability with providers; the ability to add new services that might not otherwise be possible, like a data warehouse and a transparency tool to help people research the cost of medical procedures; and the ability to ensure that care is appropriately managed for these employees who will be inherited into the state retiree plans. These bills ended up in Senate Finance and in House Labor and Commerce, where the committee chairs expressed an interest in working on them over the interim.

COMMISSIONER HULTBERG stated that Administration did not take an official position during this legislative session on SB 90 and HB 196, but did speak to the potential benefits of insurance pooling and will continue to do so next year. COMMISSIONER HULTBERG added that there will be significant resistance from some of the stakeholder groups concerned about losing local control, and from trusts and organizations that currently provide insurance to some of these groups, and she expects to see more discussion of these bills over the interim and during the next legislative session.

MR. PIHL asked if a fiscal note had been prepared; COMMISSIONER HULTBERG stated that there were three fiscal notes associated with it, but they were difficult to understand, and she suggests the board ask Deputy Commissioner MIKE BARNHILL to explain them. COMMISSIONER HULTBERG explained that essentially, the ARMB would bill the school districts the benefit credit, which is generally lower than the benefit credit most districts are currently paying, and the school districts would be required to have their employees as part of the Alaska Care plan. MR. PIHL asked whether the money would flow through the retirement system, and COMMISSIONER HULTBERG replied that it would not.

CHAIR SCHUBERT asked whether COMMISSIONER HULTBERG's department has seen any requests by beneficiaries for medical procedures outside of Alaska; COMMISSIONER HULTBERG replied that they do receive those requests, and enhancing travel benefits is on their long-term list of things to do. The travel benefit now only applies to surgical procedures, not diagnostic procedures, and does not allow benefits for someone to accompany the beneficiary. COMMISSIONER HULTBERG stated that they have issued an RFP for a new third-party administrator, and they are currently reviewing the proposals that have been submitted.

MR. PIHL noted that when the travel benefit is extended, they should make sure that the payment would be based on the cost of a procedure Outside, not in Alaska, as he knows of a workers' comp case in which the Alaska schedule was charged even though the work was done in Seattle. COMMISSIONER HULTBERG remarked that before the benefit is extended, they have to figure out how to demonstrate that there would be a savings in order to approve the travel.

MR. BRICE asked who establishes the benefit levels for retirees; COMMISSIONER HULTBERG replied that she is the plan administrator, but much of the responsibility is delegated to JIM PUCKETT, and retiree organizations such as RPEA provide input through an informal process of meetings. COMMISSIONER HULTBERG added that they are working on establishing a Retiree Plan B, a different, stand-alone plan that retirees could elect into that would offer some of the benefits people ask for while giving administrators an enhanced ability to manage costs. At the request of MS. HARBO, COMMISSIONER HULTBERG reviewed the four components of the RFPs issued for health insurance: the PMB, or pharmacy benefit manager; wellness; claims administration, traditional TPA (third party administrator); and dental network.

COMMISSIONER HULTBERG noted that dental network is a component which they don't currently have because there haven't been any dental networks in Alaska, but there are now, so they might be able to get some savings in that area. COMMISSIONER HULTBERG remarked that other states that broke their RFPs apart got different vendors bidding on different parts, which a few did on this one, but most of the vendors bid on the whole package. The department hopes to make a decision in May.

4. TREASURY DIVISION REPORT

Department of Revenue Deputy Commissioner ANGELA RODELL reported that Moody's had just released their new criteria for how they are going to evaluate states' general obligation ratings specific to adjusting the pension data. They will now discount at the taxable bond rate, currently 5.67 percent, as opposed to the current assumption of 8 percent. Also, they are doing away with asset smoothing, and will be reporting at fair or market value as of the reporting date. Alaska is rated AAA by Moody's, and the new criteria are not expected to change Alaska's rating, but will make it look different. MS. RODELL stated that she expects Moody's to publish statistics about how states rank, and when that information is released, she will bring it to the board.

5. CHIEF INVESTMENT OFFICER REPORT

Chief Investment Officer GARY BADER introduced a new staff member, EMILY PEYTON, who will work on reporting and operations within the portfolio unit and corporate bond research. Emily is a graduate of Juneau-Douglas High School and holds a bachelor's degree in Russian and mathematics from University of South Carolina.

MR. BADER reported transferring some funds among the various retirement accounts to bring them closer to the asset allocations approved by the Board, and a transfer of $36 million from Lord Abbett Small Cap Fund to the SSgA Russell 2000 Value fund.

MR. BADER responded to an inquiry from MS. ERCHINGER about liquidity in the fund with a chart showing calculation of contributions plus earnings minus benefits of the PERS and TRS retirement trust, which shows that there is sufficient liquidity to proceed with the asset classes that are available to the Board at this time. MR. BADER noted that this is only an initial response, with more to come later. Buck Consultants has been asked to provide additional information on this as it relates to the defined contribution plans, which provide a lot of liquidity to the system because many of the benefits that will be paid out of those plans won't be for several years.

MR. BADER reported that the Board has received a communication from the public advocate for New York City and the California treasurer urging the ARMB to divest from companies that produce military-grade assault weapons and large ammunition clips.

MR. BADER brought before the Board a request to approve the ownership transfer of Victory Capital from KeyCorp to Crestview Partners. It will not change any of the investment team at Victory Capital, and MR. JOHNSON has looked at the agreement and found no problems.

MS. HARBO moved to approve the transfer of ownership. VICE-CHAIR TRIVETTE seconded the motion.

The motion carried unanimously.

MR. BADER reported two rebalancing efforts that took place on March 18th and March 25th to be closer to the Board's asset allocations.

MR. BADER informed the Board that Lord Abbett intends to change their small cap fund, which had a performance beneath the Russell 2000 index, into a small mid cap fund. The ARMB has elected not to continue into the small mid cap fund, and Lord Abbett has agreed to open up a small large cap fund which has 10-year returns well in excess of the Russell 2000 growth. This fund is closed to new investors, but Lord Abbett has agreed to open it for this board and to absorb all commission costs involved in the transfer.

MR. BADER reported that they sold $75 million of intermediate treasury bonds and invested it in the BlackRock ACWI Index Fund.

In response to a request from COMMISSIONER HULTBERG for a report on fees paid by the retirement system, MR. BADER explained that the report in the packet does not include defined contribution fees, which are mostly borne by the participant. MR. BADER urged board members to read the footnotes, which reveal that there are several levels of fees that one could go down to, many of which are embedded in the returns of the managers.
MS. HARBO asked whether, when the Board gets a budget, they also get a list of the fees; MR. BADER replied that they do get a list of fees, but not of the embedded fees.

MS. ERCHINGER asked if the liquidity schedule includes both the DB and DC plan, and MR. BADER replied that it only includes the DB plan.

6. FUND FINANCIAL REPORT

State Comptroller PAMELA LEARY commented that she was happy to have the meeting in Juneau so that some of the accounting staff could attend. MS. LEARY introduced KAYLA WISNER, TIM SHOCKLEY, SHARON GILL, and MICHELLE VUILLE, and noted that LISA TERRELL from

State Street is also in the audience.
MS. LEARY went over the fund financial report for the eight-month period ending February 28, 2013. Ending invested assets for PERS was at $12.7 billion; TRS, $5.2 billion; Judicial Retirement System, $138 million; and National Guard/Naval Militia, $34 million. For participant-directed plans, the Supplemental Annuity Plan was at $2.8 billion, and the Deferred Compensation Plan was at $664 million at the end of February. The total for all of the DB and DC plans is $21.7 billion. MS. LEARY noted that the Defined Benefit Trust plans have all had a net withdrawal over the past eight months, whereas most other plans have had net contributions during that period.

MS. LEARY noted that page 3 of the report shows graphically what is happening with the PERS retirement plan, and all the numbers are well within the bands. Short-term fixed income is slightly on the lower end of the spectrum, domestic equity is higher, and absolute return is a little lower, a theme which goes through all of the different plans.

MS. LEARY pointed out that pages 10 through 14 show the manager breakdown of all of the assets for the month of February, and page 11 shows a new fund, the ARM Board Equity Yield Strategy, which just got invested in February. MS. LEARY also noted that in response to a request from a board member, they have added the monthly increase in the net assets and the amount due to income for the monthly results for February. She added that that information couldn't be fit in for every month, but the plans are available on the website.

MR. PIHL asked about the 9.39 percent return. MS. LEARY replied that as of February, the change in invested assets was 9.39 percent, and as of the end of April it was 10.97 percent for the whole plan, with an investment income increase from 8.89 percent to 10.75 percent at the end of March.

LEE HULLINGER, the new Chief Financial Officer for the Division of Retirement and Benefits, presented a supplemental report to the financial report presented by the Treasury Division. The DRB report presented by MR. HULLINGER breaks out the third column from the left in the Treasury's report, labeled "Net Contributions/Withdrawals", into contributions and expenditures.

Page 1 of Mr. Hullinger's report shows that during the eight-month period ending February 28, 2013, the fund has received almost $644 million in contributions from employers and members. With legislative relief and other income, this comes to over $1.25 billion in total contributions so far this fiscal year.

MR. HULLINGER explained that "other income" for the various healthcare trust funds is primarily Medicare reimbursements received from the retiree drug subsidy program.

MR. HULLINGER pointed out that of the $970 million paid out in benefits so far this year, 68 percent is defined benefit pension payments to retirees in the PERS, TRS, and JRS plans, while 32 percent was spent to provide medical care for those retirees and their dependents.

MR. HULLINGER stated that total administrative expenses so far this year come to $48.6 million, about 11 percent more than the same period last year. Of these expenses, 43 percent were DRB operating expenses and 57 percent were Division of Treasury and investment-related expenses paid out by these funds.

MR. HULLINGER stated that page 2 shows $81 million in contributions received during the month of February and $117 million in benefits paid out; they also processed over $19 million in refunds and disbursements during February.

MS. HARBO asked if the approximately $15 million in refunds meant that that much had been refunded to DC people who have totally withdrawn from the system; MR. PUCKETT replied that that is correct.

VICE-CHAIR TRIVETTE noted that the Judicial Retirement System seems to be having trouble with medical, and asked whether that is ongoing or has been high in the last eight months. MR. PUCKETT replied that it has not been a serious issue, but he will check into it. COMMISSIONER HULTBERG added that the claims spending on the retiree side is only up about 3 percent compared to this time last year, and while they would look into the JRS plan, the trend for the Retiree Plan is actually pretty good this year.

MS. ERCHINGER thanked MR. HULLINGER for the deeper look at administrative expenses and for the breakdown between the Department of Administration and Revenue, commenting that this information is helpful.

7. PRIVATE EQUITY TACTICAL PLAN

State Investment Officer ZACHARY HANNA stated that his presentation was part of the annual review and planning cycle for the ARMB's investments in private equity. The more detailed written plan was included in the meeting packet. Abbott Capital Management, Pathway Capital Management, and Callan Associates, Inc., had already reviewed the tactical plan and recommendations.

MR. HANNA said the ARMB's return expectation for private equity is 350 basis points over the Russell 3000 Index. MR. HANNA explained that the private market is appealing because there are many opportunities, and private companies are generally less efficiently priced and operated than public companies, which creates an opportunity for private equity groups to improve efficiency and then sell the companies at higher valuations. The less positive characteristics of private equity include illiquidity, high fees, potential for high leverage, issues with portfolio transparency and valuation, and incomplete data and benchmarks.

MR. HANNA explained the structure of private equity investments and the usual pattern of cash flow, noting that there are three primary private equity strategies: venture capital funds, buyout funds, and special situation funds. Manager selection is critical, because access and careful due diligence is required, and diversification is important because private equity can be cyclical.

MR. HANNA stated that the fundraising in the private equity market is now roughly half of what it was during the peak years, as the peak was not sustainable. Fundraising has now become more rational and more friendly to limited partnerships. The overall level of investing activity has decreased since 2011, and the overhang of uninvested capital from the peak fundraising years is declining significantly. MR. HANNA showed charts breaking down the main sources of liquidity for private equity, with the M&A market the largest at 70 percent. The second largest source is IPOs, which decreased in 2012 largely due to the slow European markets, and third is recapitalizations, which reached an all-time high of $64 billion for 2012.

MR. HANNA stated that the ARM Board and its advisors have built a high-quality, well-diversified portfolio which has performed in the top quartile in most of the past ten years. The internal rate of return since inception is 9.4 percent, comparing favorably with the public market equivalent return of 4.9 percent for the Russell 3000. MR. HANNA stated that the Alaska retirement system is worth $600 million more than it would have been if only invested in the public equity market. MR. HANNA showed that the private equity portfolio is diversified by strategy, industry, geography, and by investment stage.

MR. HANNA stated that the commitment target for 2012 was $335 million, and during the year $268.1 million of that was committed to 26 partnerships. Commitments to date for 2013 are on pace, with $77 million committed to six partnerships so far. The outlook for private equity is expected to continue to improve in 2013. The IPO market is expected to stabilize further, and credit markets should remain open. The investment base should be measured due to increased competition for deals and relatively high prices. Fundraising is expected to recover modestly, since general partners have been returning capital and limited partner allocation issues have lessened.

For the 2013 tactical plan, MR. HANNA said staff was recommending a commitment target of $355 million — $145 million for Abbott, $125 million for Pathway, and $85 million for direct partnership investments — with a gradual increase in these totals over time. Based on the projected commitment pacing, private equity should move to its long-term allocation target of 9 percent over the 10-year planning cycle; however, it is likely to drop below its target over the mid term.
MR. BRICE asked if there was a reason why they didn't hit their target last year, and MR. HANNA replied that the long-term target and short-term targets differ, and they had been overallocated in private equity, which resulted in a lower level of commitments last year, but they think they'll hit the target this year.

COMMISSIONER HULTBERG asked about the 19.4 percent that is invested in Europe and the effect of the economic difficulties there. MR. HANNA replied that that percentage has probably already come down a little, and there has been some contraction in that segment of the portfolio, but the distressed market in Europe has been expected to pick up since 2008, and a lot of funds have been raised to try to address that opportunity.

MR. PIHL moved that the Alaska Retirement Management Board adopt Resolution 2013-03 approving the 2013 annual tactical plan for private equity investments. VICE-CHAIR TRIVETTE seconded the motion.

A roll call vote was taken and the motion carried unanimously.

CHAIR SCHUBERT recessed the meeting from 10:18 a.m. to 10:33 a.m.

8. ACTIVE/PASSIVE INVESTMENT

Chief Investment Officer GARY BADER gave a presentation on the ongoing debate over active versus passive investment management, which he said comes up about every two and a half years on the ARM Board. MR. BADER stated that he prefers to avoid the term "active VERSUS passive" because both approaches have merit and the ARMB utilizes both approaches; he views them as complementary, not mutually exclusive. While the presentation focuses on active management, he reminds the Board that they have over $3.6 billion invested passively, with almost 60 percent of the large cap investment pool passively invested.

MR. BADER began by explaining the difference between price-weighted and cap-weighted indexes, stating that the use of a capitalization-weighted index is often justified by the central conclusion of modern portfolio theory that the optimal investment strategy for any investor is to hold the capitalization-weighted portfolio of all assets. A passive investment strategy is one in which the investor invests in accordance with a predetermined strategy, usually to mimic the performance of an index such as the S&P 500, which is a cap-weighted index. Active management is the strategy where the manager makes specific investments with the goal of outperforming an investment benchmark index over the long run. MR. BADER discussed theories on efficiency of financial markets and whether active management strategies can consistently beat passive investment, then turned the presentation over to MICHAEL O'LEARY.

MR. O'LEARY spoke about his perspective on the issue of passive and active management, and the results of his analysis of managers in the Callan database. MR. O'LEARY began by explaining that the study focused on groups of managers by style: growth-oriented or value-oriented, large cap or small cap, and some with no identifiable style. The analysis looked at the managers over three-year periods, examining how they did relative to an appropriate market benchmark, and whether more of them did better by enough to overcome their fees. MR. O'LEARY stated that they have always believed that in the most efficient sectors of the market, passive management should be a big part of the portfolio, so they sought to find out whether there are certain areas of investment where active management is better.

MR. O'LEARY discussed the large cap broad equity style of management versus the S&P 500; he showed a graph demonstrating that pre-fee returns have been sometimes above and sometimes below zero, but the average has been consistently close to zero. MR. O'LEARY pointed out that a fund would have to be in the 45th percentile to cover its fees at 40 basis points, which means that a fund would be better off buying the index for 55 percent of those three-year periods.

MR. O'LEARY then examined the same style group relative to the Russell 1000 index, and said that it led to the same place. Looking at managers with a core or middle orientation, he showed a slide that showed them ending up in essentially the same place. MR. O'LEARY stated that a growing body of data show that with large cap domestic equities, a good index will be toward the middle of the pack and it will be hard for an active manager to overcome the fees.

Looking at large cap growth-oriented managers relative to the broad market, MR. O'LEARY stated that the deviations from the zero line seem to be bigger, but over a longer period, they end up in about the same place.

MR. O'LEARY noted that over a three-year period, the median small cap manager has outperformed the index regardless of the fee structure; he summed up by saying that in large cap he could understand being 100 percent passive, but in small cap he would be as heavy in active as possible. He discussed international investments and bonds, and concluded that overall, a halfway decent manager added value on an after-fee basis.

MR. BADER went over the December Callan report on the PERS, which showed that the actual return of the broad domestic pool was less than the target return, the target return being the Russell 3000 index. He explained that for accounting convenience, the managers are grouped into pools; for example, timber, real estate, farmland, energy, and TIPS are in the real assets pool. The domestic equity pool is not homogeneous, and they have not developed a benchmark. It is made up of four different investment pools, and some managers have holdings very different from the Russell 3000. MR. BADER gave some examples, including the Buy-Write Index, which they expected over the long term to deliver equity-like returns with lower risk. MR. BADER stated that there is a reason why Buy-Write is in the large pool, but it is not a good comparison to have Buy-Write and convertible bonds in the same pool, so they formed another investment pool called "other", which will not be reflected in the asset allocation until July 1st.

In deciding what time period to look at for active investment management, they graphed cycles, then compared 40 years of business cycles with 40 years of stock market returns, and found that economic cycles and the stock market are very similar. They concluded that a six-year cycle was reasonable, and the board approved an action memo changing our watch list criteria to six years.

Over the past six years, in large cap, four out of five managers beat their benchmark; in small cap, two out of three did; and in international, four out of five managers beat their index. Overall, three out of five of their index managers were able to equal or exceed their benchmark. MR. BADER noted that there is an inherent risk bias when analyzing data that excludes managers that have been terminated, especially for poor performance; however, the analysis showed that while managers over the past six years had exceeded their benchmark returns by $79 million, if the managers that were terminated had been included, that number would have been $165 million.

MR. BADER pointed out that although returns show an active management gain, active management is not free; managers' fees reduce the net gain to about a third of the total gain. MR. BADER commented that he thinks it is generally accepted that active management tends to outperform index funds in bear markets, and the Board has done a good job of selecting active investment marketers. MR. BADER told the Board about a tool called Active Share that helps monitor and select successful active managers, and noted that MR. O'LEARY had indicated that small cap is the most fertile ground for active investment dollars in his presentation.

MR. BADER stated that staff is going to increase the target passive allocation for large cap up to 65 percent, and they are going to begin equal-weighting managers of all type of assets.

COMMISSIONER HULTBERG requested that the two IAC members who missed this presentation be given an opportunity on the agenda at the next meeting to give their views on it. CHAIR SCHUBERT verified that it would be calendared. MR. BADER noted that Mr. Wilson has clearly stated his preference for passive management numerous times.

MR. JENNINGS commented on the pros and cons of indexing versus active management, stating that he believes having fewer managers is better for board oversight, because it's easier to keep track of the portfolio through time without waiting for quarterly reports; and running a broad active management program is difficult, because it requires investors to find and engage good managers and to manage the active management program. MR. JENNINGS read an excerpt from an e-mail from DR. JERROLD MITCHELL: "If a board thinks that. . . the staff consultant, the IAC, and they themselves have the ability to choose good managers that can beat the benchmarks with some regularity, then by all means, they should have more in active. But if they don't, they should have more in passive. It's a question of confidence."

MS. ERCHINGER requested that when an index is used in a report that doesn't clearly match the asset class, a footnote be included so a general audience will understand that.

VICE-CHAIR TRIVETTE reminded Trustees that the caveats that go with indexes for a particular fund are usually verbal, and tend to get lost from meeting to meeting, so perhaps they should look for a more formal way to record those caveats.

CHAIR SCHUBERT recessed the meeting from 11:58 a.m. to 1:12 p.m.

9. ACTUARIAL VALUATION REVIEW – FY 12

A. Review: Actuarial Smoothing Survey

LESLIE THOMPSON of Gabriel Roeder Smith reviewed an article published by the Society of Actuaries that explained about smoothing methods before discussing the audit of the valuations. Smoothing spreads the recognition of volatile experience into what is considered a more manageable pattern, so investors can make long-term decisions without being unduly influenced by short-term events. MS. THOMPSON advised that funding policy criteria for assessing smoothing should include whether it promotes solvency of the plan; whether it gets the plan to 100 percent funded; whether it enhances predictability of contribution requirements; and whether it creates transparency of financial information.

MS. THOMPSON showed graphic representations of how asset smoothing works. MS. THOMPSON stated that the ARM Board has an actuarial value of $6.5 billion, which is 106 percent of market, $6.1 billion, within the 80/120 corridor. Smoothing is also applied to output, and the ARM Board has gone to level dollar funding instead of level percent of pay, which results in a 5 or 6 percent increase in pension contributions. This change accelerates solvency, and is a conservative approach. MS. THOMPSON stated that amortizing year by year is how it's done in the private sector, and that the ARM Board's effective amortization period is currently 18 years, demonstrated by the Buck valuation.

B. Certification of Draft FY 12 Actuarial Valuation – PERS/TRS

MS. THOMPSON presented the findings of Gabriel Roeder Smith's annual audit of Buck's annual valuation.

Gabriel Roeder Smith (GRS) audited the Defined Contribution Retirement plan; the TRS and PERS defined benefit plans, both pension and retiree medical; and they are still working on the Judicial Retirement System and the National Guard. MS. THOMPSON talked about the changes in Buck's assumptions that led to more discussion, including the plan value offset and the new assumption that future increases in medical will be split 50-50 rather than borne by the retirees. They also questioned the assumption that the retiree medical plan for DCR members will be about 12 percent less in cost or value than the retiree medical plan for the legacy members, which they found originated in the intention to develop a network design that will lower costs. MS. THOMPSON stated that GRS cannot certify the contribution rate that goes to the legislature for approval because they don't have anything in writing.

COMMISSIONER HULTBERG remarked that the reason the numbers are not concrete is that it is a draft plan that has not been finalized. MS. ERCHINGER asked who has the authority to finalize and approve the draft that will become the plan; COMMISSIONER HULTBERG replied that she is the plan administrator. COMMISSIONER HULTBERG stated that certifying and finalizing the plan is a high priority, but it has to be thoroughly vetted first; she added that the disposition of the HRA accounts for members who have terminated is an outstanding issue that has to be worked through before they can finalize the plan.

MS. THOMPSON shared some of the results that instigated discussions with Buck. The cost sharing assumption resulted in an increase of the total employer contribution for PERS from .82 to 1.96 percent, and TRS, from .47 to 2.04 percent. These are large increases in actuarial terms, driven by the changes in assumptions noted previously, and they result in a decrease in the funded status. PERS was 134 percent funded, and now is 53 percent funded; TRS was 173 percent funded and is now at 55 percent.

MS. THOMPSON stated that because these changes were so significant, they would recommend further written documentation supporting this new funding policy regarding cost sharing. She stated that they received a good write-up from Buck, but they have no validation from Alaska that this is in fact the plan as understood by everybody. The Governmental Accounting Standards Board (GASB) requires that the plan be communicated to be substantive, and there is no documentation yet. MS. ERCHINGER confirmed that MS. THOMPSON was talking about the DCR retiree health plan, which doesn't exist except in theory, so these changes pertain to a plan that doesn't really exist; MS. THOMPSON stated that her understanding is that the plan that is being valued and the contribution rates that the Board is being asked to certify to are based on Buck's best interpretation of the ultimate plan design. MS. THOMPSON recommended that the plan be put in writing before the ARM Board certifies to the legislature for the contribution.

DANA WOOLFREY of GRS (Gabriel Roeder Smith) spoke about the audit of the defined benefit plan, explaining that the review identified an issue with the post-retirement pension adjustment timing. The way that Buck rounds ages results in a potential bias understating the liability. In test cases run by the auditors, the numbers were off by about 2 to 3 percent, sometimes more. MS. WOOLFREY stated that although these issues only affect one projection year in the valuation, it is a heavily weighted valuation year with a big retirement probability, and they recommend fixing this projection for the next valuation.

C. FY 12 Draft Actuarial Valuation Reports

DAVE SLISHINSKY, a consulting actuary from the Denver office of Buck Consultants, introduced CHRIS HULLA, a healthcare consultant, and LEE JAMES, another consulting actuary from Buck's Houston office. They went over changes in the plans and the impacts of those changes since the 2011 valuations. One significant change was the move by the Board last June from an amortization method based on level percent of payroll to a level dollar amortization.

MR. SLISHINSKY stated that there were no changes in the benefit provisions or in the actuarial assumptions for the defined benefit plans, but they are recommending some changes in the healthcare assumptions.

MR. HULLA showed a chart with prior assumptions and the assumptions that they propose to switch to, explaining that it basically means higher near-term healthcare cost trend factors due to fees over the next five years from cost shifting from the uninsured, and lower longer-term costs. The basis for this assumption is that they have a better but still evolving picture of how the healthcare reform legislation should impact healthcare plans.

VICE-CHAIR TRIVETTE requested a list of the additional fees, and MR. HULLA replied that he could send that.

MR. BRICE asked if these figures assume that the Affordable Care Act is going to hold down inflation rates; MR. HULLA replied that with features to promote wellness and more education about how to provide better care, he believes it is rational to project lower trends in the long term. MR. HULLA said that he could also send a list of these driving factors.

MR. HULLA explained that the DCR health plan design differs from defined benefit tiers in that it can be actively managed. The plan will be designed so that out-of-pocket features will increase over time as health plan costs increase over time, and there may be additional demand management features and programs to promote health or get people engaged in disease management. MR. HULLA stated that the provider and network contracting landscape in Alaska has been evolving, and Buck Consultants has helped the Division analyze plan designs that take advantage of the progress; he recommends starting to revise assumptions to reflect these changes, rather than having to make a big adjustment all at once when the plan is fully concrete.

MR. SLISHINSKY highlighted four areas that had the biggest impact on the changes in contribution rates from 2011 to 2012:

- The change in amortization method from level percentage of payroll to level dollar method for both PERS and TRS defined benefit plans resulted in a rate increase of about 7.2 percent of pay for PERS and more than 13 percent of pay for TRS.
- The investment return for FY 12 was .2 percent as a net of all expenses, falling short of the long-term rate of return of 8 percent by 7.8 percent.
- Gains on healthcare costs for next year are projected to be lower than anticipated, reducing healthcare liabilities by about 6 percent, which translates to roughly 1.75 percent reduction in the contribution rate.
- Future healthcare cost trend sharing, instead of the retirees bearing most of the cost of the increase, has a dramatic impact on the DCR contribution rate, increasing the PERS portion about 1.2 percent and the TRS portion about 1.6 percent.

MR. SLISHINSKY went through the actuarial results for the PERS closed defined benefit plan, the TRS closed defined benefit plan, and the DCR plans, emphasizing that the change in the amortization method does not change the unfunded liability for these funds.

VICE-CHAIR TRIVETTE inquired if he is correct in thinking that using the level dollar approach saves them hundreds of millions of dollars every year, and MR. SLISHINSKY replied that the total cash outlay to pay off the unfunded liability is less under the new method.

CHAIR SCHUBERT recessed the meeting from 3:13 p.m. to 3:23 p.m.

After the break, MR. SLISHINSKY went through the calculations of the additional state contribution to DCR and to health reimbursement accounts under SB 125. The PERS rate for employer contributions is capped at 22 percent of total payroll, and the TRS rate is capped at 12.56 percent of total payroll.

MR. SLISHINSKY explained that the actuarial software projects two years out. Calculating a salary for both DB and DCR members in PERS, they got $2.358 billion for total projected payroll for 2015, which results in an additional contribution by the state of $519 million for PERS and $456 million for TRS. The total state assistance for PERS and TRS is $975 million, a $272 million increase over the prior method.

D. Health Care Cost Assumptions Update – DCR Plan Design and Participation Assumptions

MR. SLISHINSKY showed where the state contribution rates were expected to go and why, comparing the two methodologies, the current level dollar method and the level percentage of pay methodology. He noted that under the level dollar method, as members in DB retire and terminate over time, the dollars coming in based on their payroll will decline. MR. SLISHINSKY stated that the state assistance contribution is expected to maximize in 2016, then decrease until the last active member is expected to retire in 2041, almost 30 years from now. By 2031 there would be no more state assistance as the rate would then drop below 22 percent, which would be paid by employers.

MR. PIHL asked why the state assistance stops two years earlier than 2031 on the graph on page 31, saying that it seems that it should continue until 2031 and require less earlier on. MR. SLISHINSKY explained that at the start of the amortization process, any unfunded liability that existed was fixed at the 2002 valuation. That valuation was used for funding for FY 05, and 25 years from FY 05 inclusive is 2029.

MR. PIHL noted that it seems to overstate the necessary state assistance early on by eliminating those two years, but that is a topic to discuss in the upcoming work session and perhaps change the funding policy.

Comparing the level percentage of pay method, MR. SLISHIINSKY showed that by 2016 the state assistance contribution would be fairly level, and the point of 100 percent funding would be reached at about the same time as by the current level dollar method.

MR. PIHL commented that in the full actuarial report, pages 56 and 57, the schedule goes all the way to 2073, showing full funding around 2031 but an $8.6 billion surplus by 2073, which is misleading. He suggests that the ARM Board should ask that the schedule run only to the point when the plan is fully funded, and a footnote should be added stating that when the funding ratio nears or reaches 100 percent, state assistance will be adjusted to maintain that level so surpluses do not occur.

MR. BARNHILL replied that MR. PIHL had brought this to his attention about a month ago; he has since discussed it with Buck, and it can be adjusted before the report is made final.

MS. ERCHINGER commented that in a work session, the Board could work on articulating what they are trying to accomplish and then pass a resolution explaining in writing what they want to actuaries to do so the actuaries would have more tangible instructions to follow. CHAIR SCHUBERT agreed that a work session would be the appropriate venue for continuing this discussion.

E. Employer Group Waiver Plan (EGWP)

MR. BARNHILL stated that actuaries from Buck Consultants will describe what EGWP means. Over the years, people have wondered why Alaskan retirement systems don't do Medicare Part D, and there has been a good reason, but new developments in the law may offer a way to reduce costs significantly. With this in mind, Buck has been invited to give a presentation on EGWPs and get the Board thinking about it, perhaps to make a change in this direction in the next year or so.

BOB FERRARO, a pharmacist in Buck's national pharmacy practice based in Phoenix, Arizona, and his partner GAIL LEVENSON, Buck's Medicare Part D subject matter expert, came to educate the Board about the value of an EGWP. MR. FERRARO stated that some parts of the healthcare reform law have made an EGWP, which is a Medicare Part D waiver, a more financially advantageous way to cover prescription drugs for retirees without reducing the benefit or increasing the cost share, because the state would receive much more substantial subsidies from CMS (Center for Medicare and Medicaid Services). An EGWP would match the current benefit via two plans:

the initial primary plan, which is the standard Part D benefit, and it will also wrap around a secondary plan that will be fully paid for by the state.

MR. FERRARO explained that the EGWP entails a lot more work for a pharmacy benefit manager (PBM) than the current retiree drug subsidy program, therefore PBM vendor administrative fees would be higher, but it would reduce the state's administrative burden. MR. FERRARO described subsidies and rebates that would come back to the state to offset these costs. He compared the projected costs under the current RDS plan and under the EGWP, and showed an estimated $7.5 million in savings under the most conservative scenario.

MS. LEVENSON described some issues that could arise in switching plans and how they could be addressed, one being that high-income retirees are subject to additional premiums that would be taken out of their Social Security checks. Board members noted that state employees do not pay into Social Security, in which case MS. LEVENSON stated that they would be billed by Social Security, but in most cases, the state will reimburse retirees for this charge.

MS. HARBO commented that most ARM Board members have not paid into Social Security, and those who are required to take Medicare Part B now have to pay that out of pocket. She added that in the last few years, Medicare Part B has been means-tested, and the rates are now about $100-$300 a month or more, so she thinks that people who have sufficient income will have higher costs under this plan. MS. LEVENSON stated that that is true, and it is similar to Medicare Part B in who it will impact.

COMMISSIONER BUTCHER asked for some examples of other states that have gone to EGWP and their experiences; MS. LEVENSON cited Alabama and Louisiana. She added that many private employers are also reimbursing people for the high-income premiums, and sometimes it's the only way they can get an EGWP approved.

MS. ERCHINGER asked if the state chooses to go this way and it doesn't pan out, whether it would be possible to go back to the previous plan. MS. LEVENSON replied that the state would have to remain in the EGWP for the year, but could opt out for the following year, because the state is required to reapply each year around October for the retiree drug subsidy for the following fiscal year.

MR. PIHL asked if the financial analysis should show a reduction in administrative costs to the state, since they would be paying the PBM for administrative services; MS. LEVENSON replied that the savings would not be much, as the state might now have only one employee administering the RDS system. COMMISSIONER HULTBERG stated that they had asked that question before, and it's not significant enough to offset those administrative costs. MR. PUCKETT added that it was estimated to be three-quarters of a full-time person handling the RDS.

VICE-CHAIR TRIVETTE asked about the mirroring of the plan design and the cost sharing programs called LIPS and LICS. MS. LEVENSON explained that the plan will maintain whatever a person's current co-pay is, and when a person hits the coverage gap, it would stay at 25 percent co-pay until the beneficiary hits their true maximum out of pocket. The Low Income Premium

Subsidy, or LIPS, would be provided on a monthly basis, and the Low Income Cost Sharing, or LICS, reimburses medication costs for low-income retirees.

MS. LEVENSON went on to say that a Health Information Claim Number (HCIN) is an absolute requirement for the EGWP, and the state does not have those numbers now, but Buck would work with Medicare to get them. There would also be a lot of confusing communication, but EGWPs do have latitude to edit, insert documents, and take other steps to make it easier for retirees to understand. She suggested attending retiree meetings to educate people and staff about EGWPs.

VICE-CHAIR TRIVETTE asked what VDSA means; MS. LEVENSON explained that it stands for Voluntary Data Sharing Agreement, a process in which Medicare is provided information, then Medicare provides the HICNs. She stated that it is a relatively timely process, and it can be costly. MS. LEVENSON stated that there are other ways to get HICNs, but VDSA is a great way to not to just identify people who are Medicare-eligible but are actually disabled.

COMMISSIONER HULTBERG stated that an EGWP might help the trends by 1 or 2 percent, so the Department wanted to look at pursuing it and bring the topic to the ARM Board.

RECESS FOR THE DAY

CHAIR SCHUBERT recessed the meeting at 4:44 p.m.

Friday, April 19, 2013

CALL BACK TO ORDER

CHAIR SCHUBERT reconvened the meeting at 9:00 a.m. Trustees Trivette, Harbo, Erchinger, Pihl, Brice, Ryan, Hultberg, and Butcher were also present.

REPORTS (Continued)

10. PERFORMANCE MEASUREMENT 4TH QUARTER

MR. O'LEARY from Callan Associates pointed out the graph on page 3 of the presentation, which shows that 2012 was almost a complete reversal of 2011. Equity returns and indices were up, and the first quarter of 2013 has been good. However, it has not been a friendly environment for active managers to add value. He discussed investment returns in international and U.S. markets in the past and present for different asset classes. Using PERS as a proxy for all of the ARMB plans, because they all have the same asset allocation targets and similar patterns except for the militia, MR. O'LEARY stated that domestic investments were overweight and international were underweight; fixed income was over target and cash was under target.

MR. O'LEARY stated that domestic equity, private equity, and fixed income outperformed their target during the most recent quarter, while real assets and international investments underperformed. Absolute return also underperformed, at 11.8 percent for the full calendar year, versus a target of 12.4 percent. MR. O'LEARY compared three years' annualized performance to the targets, and stated that cumulative returns were very close but below the target index.

PAUL ERLENDSON discussed the individual account plans, stating that across the board, these funds have been doing well, except for Brandes, which continues to have trouble with their deep value orientation. MR. ERLENDSON remarked that this is disappointing but consistent with the way they run money.
MR. O'LEARY stated that they have entered into a deal with InvestorForce, which has a larger number of funds in their database, to have their data as well. In the InvestorForce total plan sponsor database, the median in each situation had a lower return than in the Callan database.

MR. O'LEARY stated that one of their objectives for calendar year 2013 is to have meaningful fee data on plans across the database, and broadening the group will expand the validity of things like fee comparisons. This change to using InvestorForce is effective as of March 31, but they will still have the Callan database information. He discussed different managers and their performances. MR. PIHL asked if the ARM Board decided to change managers, whether Callan would have information on the 15-year, 5-, 3-, and 1-year performance of various options that might be compelling to the Board. MR. O'LEARY replied that there are not many organizations that haven't had significant changes over 15 years, stating that if they have a 15-year record, they will probably have an inferior ranking, and he worries more about changes in philosophical approach than about shorter-term performance.

VICE-CHAIR TRIVETTE suggested that when the Board puts somebody on the watch list, they might want to put down in writing some of the issues driving that decision to help the Board remember what the issues were and what has happened since. MS. RYAN asked if the next time they are together, they would see the differences and how they affect previous information the Board has been given. MR. O'LEARY stated that they would send that out in advance of the next meeting.

11. ADOPT ASSET ALLOCATION: RESOLUTIONS 2013-04, 2013-05, and 2013-06

MR. BADER reminded the Board that at the February 2013 meeting, they heard the Callan capital market assumptions, which are the basis for determining a recommended asset allocation to the Board for the following fiscal year. On March 22nd, MR. BADER met with MR. O'LEARY, DR. JENNINGS, DR. MITCHELL, and MR. WILSON to try to form a recommendation for asset allocation to the Board. MR. BADER stated that MR. O'LEARY presented some materials in that meeting which he will go through briefly to put the meeting in context.

MR. O'LEARY explained that they create a composite for the ARMB real asset portfolio, and in preparation for the teleconference with the IAC and staff, they had developed some alternatives to the policy that was in place for FY 2013 in an effort to increase the expected return without significantly changing the risk profile. The most significant point is that they had a long conversation about the need for liquidity and concluded that 6 percent in cash is too high and the cost of earning nothing on that is too great. Recognizing that 3 percent cash might get run down during the course of a year, they looked at increasing the real asset category and private equity. Page 5 of the report shows expected returns over multiple holding periods for the 2013 policy, and the report shows the contrast between that and the current policy. MR. O'LEARY noted that he is happy that the ARM Board continues to have high-quality government-oriented bonds, as they are a form of insurance in the event of serious economic problems.

Discussion ensued about the strategy of emphasizing the international investments; MR. O'LEARY stated that he believes, as many do, that the growth in emerging economies will be significantly greater than the growth in developed markets. MS. ERCHINGER and MR. PIHL expressed their support of this recommendation; DR. JENNINGS stated that comfort and good returns don't always go together, and this is a longer-term strategic plan. COMMISSIONER BUTCHER concurred that although the Board may feel a little uneasy, managers and experts emphasized that the international market is a great opportunity.

COMMISSIONER HULTBERG asked MR. O'LEARY to explain the distinction between domestic and international equity, because the company may not be located where the market is. MR. O'LEARY replied that some of the best emerging markets exposure can be gained through U.S.-based companies that are selling products or delivering services in emerging markets, and the index reflects the legal domicile of the corporation. DR. JENNINGS suggested that it might be useful for the Board to have an education session on the difference between international small cap, emerging, and developed international, as well as currency hedging.

<u>MR. PIHL moved to approve Resolutions 2013-04, 2013-05, and 2013-06. MS. HARBO seconded the motion.</u>

MS. ERCHINGER suggested that it might be helpful to have the projected arithmetic return on the resolutions as well as the expected 5-year geometric return, to answer the question some people might have of why the Board is shooting for a return that is lower than the assumed rate of return. MR. BADER replied that that would not be difficult to do; there were no objections, so the Board requested the addition of that information.

A roll call vote was taken, and <u>the motion passed unanimously.</u>

CHAIR SCHUBERT recessed the meeting from 10:40 a.m. to 10:55 a.m.

12. TAXABLE MUNICIPAL BONDS SEARCH

MR. BADER stated that the Board had approved a search for a manager of taxable municipal bonds following a presentation by Alaska Permanent Capital. Callan was engaged to do a search, which was narrowed down to seven firms. MR. BADER and MR. MITCHELL visited two of the firms, Guggenheim Investments and Western Asset Management, and invited them to present at today's meeting.

MR. O'LEARY described Callan's process of selecting these two management firms. He stated that there were essentially no managers with a significant business managing portfolios with a focus as narrow as taxable municipal bonds, but there are many who invest in taxable municipal bonds as part of a total fixed income portfolio. Asked if they would be interested in pursuing this sort of assignment, many said no, it was too much of a niche area, so Callan developed a customized request for information, requesting a description of the process they would utilize, details with regard to their specific histories in municipal bonds of any type, and identification of their resources allocated to this type of activity. This request led to a group of about 15-20 firms, which Callan's consultant BRETT CORNWELL talked to, and from that point they narrowed the field to the seven that MR. MITCHELL and MR. BADER visited.

COMMISSIONER BUTCHER asked whether there was a route for an Alaskan firm to get business with the ARM Board through this process, acknowledging that he couldn't imagine an Alaskan firm being able to stack up to some of these worldwide firms. MR. BADER replied that McKinley Capital was an example of an Alaskan firm that was viewed as a candidate for investing Alaskan funds, and Callan Associates were asked to examine whether McKinley Capital was institutional quality in the work that they were doing for others. McKinley Capital was completely vetted by Callan, and was eventually awarded an initial mandate that grew over time.

MR. O'LEARY expanded on this situation, stating that he pushed pretty hard internally to have Alaska Permanent Capital included in this search because they were the source of information that drove the decision to even consider this narrow area, but they didn't have a taxable municipal bonds product in existence, and the committee decided not to advance them. COMMISSIONER BUTCHER added that he sits on other boards where Alaskan firms do business with the funds, so he was trying to figure out if there was some kind of exclusion, and maybe the Board should talk about that. MR. O'LEARY confirmed that one of the reasons the Alaskan firms weren't picked was because they don't currently invest in taxable municipal bonds, and the candidates all have extensive municipal bond research and portfolio management experience.

The Board heard presentations from the two firms that were selected.

A. Guggenheim Investments

CHRIS COOK expressed thanks from CIO Scott Minerd for the opportunity to present to the ARM Board. MR. COOK introduced JAMES PASS, the Senior Managing Director of Guggenheim, who joined the firm in 2009 with extensive background in investment banking. MR. COOK stated that he himself has been with Guggenheim since 2006, when they started presenting the firm to opportunities besides the one client that owned 35 percent of the company.

MR. COOK referred to page 7 in the presentation, showing an overview of the firm, which has three primary businesses: asset management, insurance services, and securities. Guggenheim has about 2200 employees worldwide in 25 offices, and they are 50 percent employee-owned. They currently have about $9 billion in total municipal debt, and their management fees are 22 basis points.

MR. PASS explained Guggenheim's investment team and their macrocentric philosophy, emphasizing that research is the cornerstone of what they do. Every bond that they buy, they have a relationship with the budget director, the treasurer, or the CFO. Predominantly those bonds represent highly endowed private universities, health care institutions, and pension fund obligation bonds. MR. PASS stated that in the current taxable municipal bond arena, greater risk does not lead to greater compensation, so they stay in single-A or double-A categories and focus on essential revenue bonds.

VICE-CHAIR TRIVETTE requested a list of clients, and MR. COOK replied that he could provide that to the Trustees.

MR. ERLENDSON asked how quickly a portfolio could be put together and what it might look like. MR. PASS replied that it would probably take about six months, and would most likely be concentrated in higher education and healthcare, with a portion also in military housing.

CHAIR SCHUBERT recessed the meeting from 11:49 a.m. to 1:02 p.m.

B. Western Asset Management

JOE CARIERI, a client service executive, and ROBERT AMODEO, the senior portfolio manager and head of the municipal bond team based in New York City, represented Western Asset Management. MR. CARIERI described Western Asset as a global investment management firm founded in 1971, committed to understanding the needs of each client, identifying individualized investment solutions, and delivering superior long-term results for their clients. Their time-tested investment philosophy emphasizes three key fundamentals: long-term fundamental value discipline; employing diversified strategies; and overlaying that with robust, integrated analytics and risk management system.

Western Asset has nine offices in eight countries around the world, with a total of 865 employees, managing only fixed income assets, with over $28 billion in municipal bonds. MR. CARIERI provided a list of clients that allow the firm to use their names in presentations, and encouraged Board members to contact anyone on the list; two Alaskan entities that they manage funds for are the Alaska Electrical Trust and the Alaska Housing Finance Corporation. Western's fee structure is 25 basis points for the first $100 million, 15 basis points for the next $100 million, combined, which would average out to just under 19 basis points total.

MR. AMODEO explained that Western Asset looks at trends in the national economy in different sectors like transportation, utility, healthcare, etc., to get a macro view, then they look at specific states and how they are performing compared to the national trends to identify opportunities and potential pitfalls. A team of credit analysts then looks at the fundamentals of specific bond issuers for security. They combine the top-down macro view and the bottom-up security analysis, look at what the market is charging for a particular risk, and assess whether they will get paid for owning the risk that is embedded within a security. The team includes seven portfolio managers followed by seven research analysts, each focused on a specific sector. MR. AMODEO explained the factors that they consider in assessing risk, and stated that they favor revenue bond sectors over general obligation debt sectors.

C. Trustee Discussion/Selection

GARY BADER, CIO, stated that staff thinks both Guggenheim Investments and Western Asset Management are well-suited to operate this mandate. Calculations of fees on a $100 million mandate are $220,000 for Guggenheim and $250,000 for Western Asset. MR. O'LEARY stated that they hoped to compare the performance of the two firms over one, three, five, and seven years, but there was not meaningful data to make such a comparison; both firms have good track records in managing related products, but not the identical product that the Board is looking to hire.

MS. ERCHINGER asked what class the money for this investment would come from; MR. BADER stated that the asset allocation that the Board approved before the lunch break reduced fixed income and cash. He stated that this award would come from fixed income, and would not result in a different asset allocation than was passed by the Board.

Deputy Commissioner ANGELA RODELL asked if this is a good time to move in this direction; MR. BADER replied that he looks at it as getting a start in something that could develop into an asset class that others will want to get into in five or ten years, as was the case when the Board invested in farmland.

MR. BRICE moved that the Board allocate $100 million to Western Asset Management for taxable municipal bonds. MR. PIHL seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

COMMISSIONER BUTCHER moved that the Board invest $100 million with Guggenheim Investments for taxable municipal bonds. MS. RYAN seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

13.

A. RFS – Investment Advisory Council

MR. BADER reminded the Board that a year ago, Mr. Wilson's contract with the IAC was extended for one year. MR. WILSON holds Seat 1, which has the following description as read by MR. BADER:

> "The candidate shall possess experience and expertise in financial investments and management of investment portfolios for public, corporate, or union benefit funds, foundations, or endowments. Preference will be given to candidates with a minimum of ten years of experience as a manager, director, and so on."

MR. BADER stated that staff recommends that the Board direct it to advertise and solicit applications from MR. WILSON and other persons interested in serving on the Investment Advisory Council.

VICE-CHAIR TRIVETTE moved to do so. MR. PIHL seconded the motion.

The motion passed unanimously.

B. RFP – Review Actuary

MR. BADER stated that Gabriel Roeder Smith (GRS) was awarded a contract as reviewing actuary as of March 1st, 2006, following a procurement by RFP. The contract term specified five years with two optional periods for renewal, which have now been exercised. The current contract with GRS ends on June 30, 2013. Staff has developed an RFP with a timetable to ensure that a review actuary can be in place by July 1, 2013, to conduct their required review. MR. BADER stated that the recommendation is that the Board direct staff to prepare an RFP for a reviewing actuary and to conduct the valuation assumption reviews as required by statute.

MS. ERCHINGER expressed concern about the lack of competition for these services, because there are few firms in Alaska that are eligible to do this kind of work. She suggested that it might be advantageous to try to have the expiration of contracts for these kinds of services coincide to enhance opportunities for competition, because otherwise some firms are precluded from bidding because they are already in cycle with a contract. Also, she suggested that a single RFP with a number of different scopes would allow firms to bid to provide various services under one RFP.

MR. JOHNSON stated that the statute requires coordinating with the Department of Administration, and a sole-source procurement would have to be approved by the Board. He stated that they could assert that there is a basis to engage in sole-source procurement for the purpose of reconfiguring the timing of RFPs when only a limited number of qualified applicants exist, but it would have to be vetted with Mr. Poag at the Attorney General's office.

MR. BARNHILL questioned whether there is really a dearth of actuaries, listing some that he knew of, and noted that overlapping contracts can be good for transitions and learning curves.

Discussion ensued about how this could be handled. MS. ERCHINGER stated that if two of five candidates are excluded from bidding because they are already providing actuarial services, that limits the Board's ability to get the best competitive environment and potential cost savings. However, even if they made this change, the situation could arise again with some contract terms being extended and others not.

COMMISSIONER HULTBERG said that the Department of Administration will cooperate with the Board's wishes regarding the secondary actuary, but the decision regarding a sole-source procurement is under the authority of the chief procurement officer by statute.

MR. JOHNSON cited 15 AAC 112.190, which provides that when a reference in the procurement code requires action by the chief procurement officer (CPO), the matter shall be referred to the Board. However, MR. JOHNSON said that it would still be good to consult with the CPO. COMMISSIONER BUTCHER suggested doing due diligence and background work and bringing some options back to the next ARMB meeting. MR. JOHNSON pointed out that by regulation, they would have to approve a sole-source procurement at a regular meeting, which would mean the early June meeting, and that might not be timely; MS. HALL stated that since the actuary starts the valuation process in late August or September, it could work.

MS. ERCHINGER submitted five findings in support of a sole-source contract, and moved to direct staff to prepare a contract with GRS to expire on June 30th, 2014. The motion was initially tabled, but discussion followed, with some questioning whether a motion that was tabled could be discussed under Robert's Rules.

VICE-CHAIR TRIVETTE recessed the meeting from 2:40 p.m. to 2:54 p.m. while MR. JOHNSON consulted the rule book.

After the break, MR. BADER asked to proceed with the action memo in front of the Board to do a one-year procurement, which would accomplish MS. ERCHINGER's desire not to bar firms committed to service to the Board from bidding on another actuarial contract, and then the RFP for the main actuary could be crafted to maximize the competition.

MS. ERCHINGER moved to direct staff to prepare an RFP for a review actuary to conduct the valuation assumption reviews as required by statute, the term of the contract to be one year with three one-year options to extend at the discretion of the state. MS. HARBO seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

C. Contract Renewals

Callan Associates, Inc.

MR. BADER stated that in consultation with the Commissioner, staff recommends exercising the second one-year option to renew the Callan contract.

MS. HARBO moved to do so. MR. BRICE seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

Townsend Group, Inc.

MR. BADER stated that staff recommends that the board exercise the second one-year option to renew the Townsend contract.
MS. HARBO moved to do so. MS. RYAN seconded the motion. A roll call vote was taken, and the motion passed unanimously.

14. ALLOCATION OF ACTUARY COSTS: RESOLUTION 2013-07

MS. ERCHINGER stated that she thinks the administration has done a good job of allocating actuary costs to the retirement system versus the general fund, and the purpose of Resolution 2013-07 is to express the Board's expectation that actuarial costs that are charged to the retirement systems are seen by the Board as appropriate. MS. ERCHINGER stated that she and MR.

BARNHILL worked on some language to express the Board's support for these charges, which is included in the meeting packet.

MR. BRICE moved to approve Resolution 2013-07. MS. HARBO seconded the motion.

COMMISSIONER BUTCHER asked what kind of numbers they are talking about that if they followed this resolution would not be charged to the retirement funds. MR. BARNHILL stated that it would be $100,000 or $200,000 over the course of a year.

MR. BADER stated that this resolution makes him question what governance the Board exercises, since it requires Board approval; he noted that he has asked for additional information from the actuaries during Board sessions and it did not require formal approval, which indicates that there are no policies about how to secure approval for such requests. MR. BADER pointed out that MS. ERCHINGER had asked for a work session on governance, and there should be some direction from the Board for how staff or contract staff responds to inquiries from an individual trustee without a formal action from the Board. VICE-CHAIR TRIVETTE acknowledged that at times the Board is not sure how to go about doing things, and they will have to continue to address this issue.

A roll call vote was taken, and the resolution was approved.

VICE-CHAIR TRIVETTE recessed the meeting from 3:12 p.m. to 3:24 p.m.

UNFINISHED BUSINESS

1. Disclosure Reports

MS. HALL stated that the disclosure reports were included in the meeting packet, and there was nothing unusual to disclose. MS. HALL also stated that CHAIR SCHUBERT had signed the quarterly ethics report before she left, and there was nothing to report on that either.

2. Meeting Schedule

MS. HALL noted some changes to the schedule:

- The Defined Contribution Committee would be meeting on June 19th.
- The Legislative Committee will be meeting in a strategy session on June 19th and doing additional legislative planning for the September meeting.
- The Legislative Committee added a meeting on December 4th.

Everything else is unchanged.

3. Legal Report

MR. JOHNSON responded to a question from COMMISSIONER HULTBERG about the distinction between regular and special meetings. He stated that there is no definition of "regular", but there is recognition that there are two different kinds of meeting. MR. JOHNSON added that he thinks a work session on governance issues and the roles and duties of the ARM Board would be worthwhile, as some of the regulations originate from before the ARM Board was created from the ashes of ASPIB, and he would be happy to assist the Board in a discussion.

NEW BUSINESS

None.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD

None.

PUBLIC/MEMBER COMMENTS

Deputy Commissioner MIKE BARNHILL stated that earlier this week he visited California's CalSTRS as part of a conference for pension professionals, and it was very interesting to see how pension programs are delivered on a much larger scale than in Alaska. California has 25 communication staff and 51 call center staff, so they answer all calls within 30 seconds. MR. BARNHILL noted that Alaskan stakeholders have expectations just as high as Californians, but the Alaskan program is administered with a fraction of the staff, so he complimented the staff of the Treasury and the DRB for delivering a high-quality program with so few people.

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. JENNINGS, recalling the discussion of governance, noted that there is a small and growing literature on pension governance among academic practitioners, and he thinks "governance" can mean different things. He offered to summarize the information for the Board. VICE-CHAIR TRIVETTE acknowledged that there are different definitions of "governance" and thanked DR. JENNINGS, remarking that it would be informative to discuss that.

TRUSTEE COMMENTS

COMMISSIONER HULTBERG thanked the Board for working through the procurement issue that was discussed earlier and finding a way to accomplish the objectives of the Board in a way that she feels more comfortable with.

MR. PIHL stated that he holds MR. SLISHINSKY from Buck in high regard for how open he has been, and clear and responsive in answering questions. MR. PIHL commented that he thinks the work session with the actuary is going to be very good for everyone.

MS. HARBO thanked TRUSTEE ERCHINGER for her work and leadership on the resolution to make sure actuary costs are properly assigned.

MS. ERCHINGER stated that she agrees with MR. PIHL that both actuaries do an excellent job and make their work easy to follow and understand. She remarked that when the Board asks questions, she appreciates the patience of the actuaries, as the questions are really an attempt to move beyond standard actuarial reporting to get information presented in a manner that reflects the particular interests of the ARM Board.

MS. ERCHINGER also thanked the Department of Administration for the tremendous amount of work that they are doing to help the Board understand what is happening in healthcare. She also thanked MR. BADER for the information he provided in response to the questions that she asked at the last meeting.

MR. O'LEARY corrected a mistake: In his discussion under Agenda Item No. 8, he had stated that the Japanese weight at its high was 80 percent, but it was actually 65 percent in the fourth quarter of 1988.

VICE-CHAIR TRIVETTE noted that the Board has had only one planning session since its inception in 2005, and it's probably time to do it again, suggesting around the middle of October. He asked board members to send their comments to MS. HALL and MR. BADER about issues that should be addressed at the planning session so they can figure out whether one day will be sufficient. Staff will work on arranging a date.

VICE-CHAIR TRIVETTE also thanked both departments for their skill and support, remarking that without their good management, he would not have asked and been reappointed twice since his first appointment expired.

FUTURE AGENDA ITEMS

Two IAC members who missed the presentation on active versus passive investment will be given an opportunity at the next meeting to give their views on the subject.

ADJOURNMENT

There being no objection and no further business to come before the board, the meeting was adjourned at 3:48 p.m. on April 19, 2013, on a motion made by MR. BRICE and seconded by VICE-CHAIR TRIVETTE.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary

Note: Glacier Stenographic Reporters, Inc., an outside contractor, provided court reporting services for the meeting and prepared the summary minutes. For in-depth discussion and more presentation details, please refer to the transcript of the meeting and presentation materials on file at the ARMB office.