State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location:
Fairbanks Westmark Hotel
813 Noble Street
Fairbanks, Alaska

MINUTES OF
September 18-19, 2014

Thursday, September 18, 2014

CALL TO ORDER

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

ROLL CALL

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

Board Members Present
Sam Trivette, *Vice Chair* (Arrived after lunch)
Gayle Harbo, *Secretary*
Kristin Erchinger
Commissioner Angela Rodell
Commissioner Curtis Thayer
Tom Brice
Sandi Ryan (Arrived late)
Martin Pihl

Board Members Absent
Gail Schubert, *Chair*

Investment Advisory Council Members Present
Dr. William Jennings (telephonic)
Dr. Jerrold Mitchell
Robert Shaw

Department of Revenue Staff Present
Gary M. Bader, Chief Investment Officer
Scott Jones, State Comptroller
Pamela Leary, Director, Treasury Division
Steve Sikes, State Investment Officer

Shane Carson, State Investment Officer
Bob Mitchell, State Investment Officer
Judy Hall, Board Liaison

Department of Administration Staff Present
Jim Puckett, Chief Operating Officer, Division of Retirement & Benefits
Kevin Worley, Chief Financial Officer, Division of Retirement & Benefits
Mike Barnhill, Deputy Commissioner

Consultants, Invited Participants, and Others Present
Robert Johnson, ARMB Legal Counsel
Chris Hulla, Buck Consultants
David Slishinsky, Buck Consultants
Dana Brown, Callan Associates, Inc.
Paul Erlendson, Callan Associates, Inc.
Stuart Goering, Department of Law, Assistant Attorney General
Leslie Thompson, Gabriel Roeder Smith
Charlie Gallagher, Northern Region RPEA
Melody McDonald, RCM/Allianz
Jeff Sheran, RCM/Allianz
Greg Tournant, RCM/Allianz
David Stenger, Sentinel Real Estate Corporation
David Weiner, Sentinel Real Estate Corporation
Micolyn Magee, Townsend Group
Tom Anathan, UBS Real Estate
Jeff Maguire, UBS Real Estate

PUBLIC MEETING NOTICE

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

APPROVAL OF AGENDA

MR. BRICE moved to approve the agenda. MS. ERCHINGER seconded the motion.

ACTING CHAIR HARBO added item VII. 2.E. Defined Contribution Committee Report to the agenda.

The agenda was approved as amended.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS, AND APPEARANCES

CHARLIE GALLAGHER, Chair of the Northern Region RPEA, welcomed the Board to Fairbanks, and expressed his appreciation for the legislative appropriation of $3 billion into the pension funds. He commented most of his board's time is spent on sorting out issues regarding the new Aetna health plan. MR. GALLAGHER noted he looks forward to hearing MR. BADER's information.

APPROVAL OF MINUTES: June 26-27, 2014

MR. BRICE moved to approve the minutes of the June 26-27, 2014 meeting. MS. ERCHINGER seconded the motion.

The minutes were approved.

COMMISSIONER THAYER requested the minutes reflect he was in attendance both days at the June 26-27, 2014 meeting, but was tardy during roll call.

REPORTS

1. CHAIR REPORT

None

2. COMMITTEE REPORTS

A. Audit Committee

MR. PIHL reported the Audit Committee met September 17, and all members were present, Trustee PIHL, Trustee ERCHINGER and Trustee HARBO. There was full presence by Treasury staff and Department of Administration staff. The main agenda item was the report from KPMG on the completion of the Treasury audit. There are no matters to be brought before the Board and everything is clean and going very well.

MR. PIHL informed the Department of Administration gave a good report regarding employer audits. He noted the concerns and problems are quite serious, and some rise to the question of fraud. MR. PIHL believes it is incumbent on employers for completeness and accuracy in reporting and remitting contributions. MR. PIHL stated the Department of Administration, under MR. BARNHILL's leadership, is responding to the problems and there has been great improvement in the employer audit program.

MS. ERCHINGER clarified the use of the word fraud, noting the context is in relation to the employer audits and identification of specific employers who have questionable practices, and is in no way related to the work of the Board or the State of Alaska.

B. Budget Committee

None

C. Legislative Committee

None

D. Real Assets Committee

MS. ERCHINGER commented the Real Assets Committee had an excellent meeting on September 17. She expressed her appreciation to STEVE SIKES, State Investment Officer, and MICOLYN MAGEE, Townsend Group, for their informative presentations at the meeting. The role of real assets in the portfolio is primarily diversification and inflation hedging. It is comprised of 17% of the overall assets, representing $3.6 billion in value at June 30th, 2014. The long-term performance expectation is 5% net real return over rolling five-year periods. The performance has been excellent, with the three-year mark at 11.23% and five-year mark at 9.59%. The 2013 performance provided a 13.15% return, exceeding the target of 10.98%.

MS. ERCHINGER informed the Real Assets Committee is recommending the approval of two resolutions today; the adoption of the real assets annual investment plan and the annual adoption of the real estate investment policies, procedures, and guideline modifications.

E. Defined Contribution Committee

MR. BRICE informed the Defined Contribution Committee met September 17. Reports were given and the Committee will recommend an action item to the Board later in this meeting.

3. RETIREMENT & BENEFITS DIVISION REPORT

A. Membership Statistics (informational)

JIM PUCKETT, Chief Operating Officer, noted the membership statistics are included in the Board packets and there is nothing of consequence to report. The trends remain the same; the DB populations for PERS and TRS are steadily decreasing and the DC populations for PERS and TRS are steadily increasing. The number of retirees is steadily increasing.

B. Buck Consulting Invoices (informational)

MR. PUCKETT reported the expense for the actuarial evaluation this year was $83,000 less than in 2013. The overall expense to Buck was $71,000 more this year because of the increased list of services provided.

ACTING CHAIR HARBO asked why the ARBM was paying for the Aleutian Region School District line item. MIKE BARNHILL, Deputy Commissioner, informed the litigation was brought by that particular employer for a refund of their account balance and is a direct litigation against the corpus of the trust fund.

MR. BRICE inquired why the Aleutian Region School District line item is being billed under PERS and not TRS. MR. BARNHILL explained all school district employers are PERS employers, because only the teachers are in TRS and all other employees are in PERS. This litigation is a request for a refund of the PERS account.

4. TREASURY DIVISION REPORT

A. FY 16 Budget - Action

PAM LEARY, Director, Treasury Division, informed there are many statistics to report with the close of the fiscal year 2014. She congratulated Chief Investment Officer GARY BADER and his team for achieving returns of 18.56% on the major DB plans and noted they are in the top 10% of the public funds in Callan's database. The Treasury staff now manages over $52.2 billion, which is an all-time high.

MS. LEARY announced SCOTT JONES received his Certified Investments and Derivatives Auditor designation and JOY WILKINSON achieved the CFA designation. Governor pins for service and longevity have also been awarded to investment staff.

MS. LEARY stated the Board has been provided an action memo and worksheet. The Budget Committee reviewed the results of the fiscal year 2014 in relation to the amount authorized, as well as the fiscal year 2015 projected, and fiscal year 2016 proposed budget items. The action memo has a typographical error and the Budget Committee did not meet in 2012 as stated.

MS. LEARY advised that the recommendation of the Budget Committee and staff is that the Board adopt the fiscal year 2016 proposed budget as attached, with the understanding that salary increases will be included during a review by OMB and the Legislature.

<u>COMMISSIONER RODELL moved to adopt the fiscal year 2016 budget. MR. BRICE seconded the motion.</u>

<u>The motion passed unanimously.</u>

5. CIO REPORT

MR. BADER introduced STUART GOERING, Assistant Attorney General, Department of Law, who will be taking ROB JOHNSON's position as attorney to the Board. There is also an RFP from the Department of Law to obtain services of additional legal counsel. MR. GOERING informed the Board he has been with the Department of Law for about six-and-a-half years and was previously in private practice in Anchorage. He currently represents the ARM Board and the Regulatory Commission of Alaska.

MR. BADER reviewed the CIO Report included in the Board's packet. The dates of the rebalances are listed on the summary sheet and the most recent rebalance paperwork is provided. MR. BADER can provide all rebalance paperwork at the request of the Board. MR. BADER explained the changing balances with the absolute return managers. Two years ago, the Board decided to work with the absolute return managers and relax their constraints.

Initial returns indicate that decision was useful and as of the June 30 year-end, the absolute return category returned 6.51% versus their target return of 5.1%.

MR. BADER informed the buy-write account was rebalanced between the two managers State Street and Analytic. The next item related to the receipt and investment of one billion dollars of the three billion dollars, which is being made from the constitutional budget into the retirement funds. A deposit of $333 million was made into the PERS Defined Benefit pension account, $554 million was deposited into the TRS Defined Benefit pension account, and $112 million was deposited into the TRS health account.

The funds of the PERS and TRS pension and health accounts are pooled. The investments were as follow; $50 million into Russell 1000 Value Fund, $150 million into Russell 1000 Growth, $200 million into Allianz International investment account, $200 million into Baillie Gifford investment account, $100 million into internally managed Treasury account, and $300 million into cash. MR. BADER advised a similar transaction will occur around November 13.

The next item reflects the transfer of funds from BlackRock ACWI Ex-US to Eaton Vance and Lazard emerging market funds. The next item relates to a press release from Relational Investors, who are no longer making new investments to the account, due to health issues surrounding one of the founding partners. MR. BADER believes Relational Investors are good stewards of their current assets and will keep the Board informed on their status.

Not included in the Board's packet relates to a $40 million investment with New Mountain Capital. This private equity fund was reviewed by staff and by Callan and was considered a good investment. The Chair was informed of the process.

6. FUND FINANCIAL REPORT with Cash Flow Update

State Comptroller SCOTT JONES and CFO of the Division of Retirement and Benefits KEVIN WORLEY presented the Fund Financial Report. MR. JONES reviewed the financial statements for the month ending July 2014. The PERS system ended with $15.5 billion, the TRS system with $6.9 billion, the JRS with $168.8 million, the National Guard and Naval Militia with $37.6 million, SBS with $3.3 billion, and Deferred Comp with $774 million, for a total of $26.6 billion. MR. JONES stated the change in invested assets was 2.43% for the time, which was largely due to the one billion dollars that was transferred in. All asset allocations were within the bands.

MR. WORLEY informed page one and two of the three-page supplemental to the Treasury Division report are the same since only one month of information is being reported. July is typically the cash inflow month. MR. WORLEY noted page three is a new item, requested by a Trustee, listing out the refunds by defined contribution plan and the primary purpose of the refunds.

MS. ERCHINGER expressed her appreciation for the helpful schedule created on page three. She asked if the magnitude of these changes reflect a typical month for separation. MR.

WORLEY noted he does not have that information, but will get back with her on that. He stated the issue of age disbursement brought up by MS. HARBO is also still being reviewed. It has been revealed that some members are checking separation of service on the forms, when they are actually retiring, and vice versa. This information is being consolidated.

MS. ERCHINGER inquired regarding the logic behind the allocation of the one billion dollars among the pension and health funds. MR. BARNHILL explained the allocation is intended to bring the pension and health funds funding ratio back into parity.

MR. PIHL asked why the billion dollars was allocated 1/3 to PERS and 2/3 to TRS. MR. BARNHILL advised the allocation is based on the total legislative appropriation of one billion dollars to PERS and two billion dollars to TRS.

7A. REAL ASSETS FY15 ANNUAL PLAN
REAL ESTATE GUIDELINES POLICIES AND PROCEDURES

MR. SIKES gave a summary version of the fiscal year 2015 investment plan of the Real Assets Program. As of June 30th, the real assets allocation was at its target at 17%. The components include real estate, farmland, timberland, energy, infrastructure, and TIPS. The overall strategy at the portfolio level is a lower risk, lower return approach, using conservative leveraged amounts and focusing on higher quality assets, producing stable returns, with an expectation of a 5% net real return over the long-term. The structure is primarily private illiquid assets, with some liquid components used for rebalancing. Implementation is spread across the ARMB staff. Important aspects of the portfolio include diversification, inflation hedging, and consistent income returns produced by the assets.

MR. SIKES noted the real assets asset class outperformed its target benchmark last year returning just over 13%. Real Estate outperformed its target returning 12.35%. Farmland underperformed its target returning 8.5%. Timberland outperformed its target returning 10.49%. The MLP sector had a terrific year returning 34.5% and the first quarter of the infrastructure portfolio had very good results with an 8.57% return.

MR. SIKES stated that staff currently has no strategic recommendations for the real assets. The plan for real estate is to continue at the core level to focus on markets with high barriers to entry. Staff intends to consider the medical office sector and UBS will provide a presentation at the October education conference regarding medical office investments. Staff also plans on reviewing additional value-added opportunistic real estate funds similar to the KKR investment for possible follow-on investments. Another strategy staff intends to research is participating mortgage investments, in which the investor receives a traditional interest payment return, but also participates in appreciation and the cash flow of the property.

MR. SIKES provided two recommendations relating to the constraints of the portfolio. The current target allocation is 90% private and 10% public, with a band of plus or minus 10%. The recommendation is to move the bands to a 20% level on the high end, with an allocation of 70% private and 30% public. This would allow staff flexibility to use REITs to achieve the real estate target and the real assets target.

MR. SIKES stated the other recommendation is within the real estate portfolio. There is currently a single manager limit of 35%. The recommendation is to increase the single manager limit to 45%. The main catalysts for the recommendation are the possible upcoming strategies of medical office and participating mortgage investments after the evaluation of the presentation by UBS Realty. Currently, UBS is at the 35% level, leaving no capacity for additional funds. Staff believes additional investment across multiple products will somewhat mitigate the risk and concerns relating to a single manager limit. No other changes to the strategies are recommended.

DR. MITCHELL expressed his appreciation to MR. SIKES for a good presentation and commended staff for selecting and sizing the real assets in an innovative and very prudent manner. DR. MITCHELL asked if there are other real asset categories in the portfolio that the Board is missing and should be participating in. He also asked if the categories are viewed as permanent or if there is ever a time to get completely out of a category. MR. BADER informed there will be a presentation at the education conference on aircraft leasing, which could be appropriate for the portfolio. MR. BADER explained staff is looking for investments that have management with a proven track record and good investment returns.

MS. ERCHINGER advised that the Committee discussed the recommendation to increase the single manager limit from 35% to 45%, and questions were answered in support of the recommendation by MS. MAGEE. The real estate portfolio stands at $1.7 billion in value. Increasing the single manager limit to 45% permits around $500 million with a single manager. The Committee recommends increasing the single manager limit to 45%.

B. CONSULTANT EVALUATION OF REAL ESTATE PLAN:
Diversification, Compliance, & Performance Measurement

MS. MAGEE expressed her appreciation to the Board for extending the Townsend Group contract and their continued relationship with the Board and staff. She gave a detailed presentation regarding the real estate portfolio. The intention is to reduce real estate exposure by allocating to additional sectors within the real asset portfolio. The target return for real estate is a five-year real rate of return of 5%. This is the first time since the global financial crisis the portfolio is exceeding its target with a 9.1% real rate of return. This is a reflection of the improved market, the stability and improvement of the real estate valuation, and the absence of inflation.

MS. MAGEE advised that Townsend reviewed the staff's proposed objectives to the staff's realized objectives and all was in line as usual. No new commitments were made to the core portfolio. An important lease and strategic decision was made to eliminate one of the separate account managers who had been underperforming and had been experiencing transitional issue with portfolio management. The positions were consolidated into the existing managers. An annual review for each separate account was conducted with staff and managers.

MS. MAGEE stated that the KKR activity was the single investment for the year in the non-core portfolio. The Townsend Investment Committee concurred this was an appropriate investment with the ARMB portfolio. MS. MAGEE believes the market is at a plateau and a pricing adjustment should be expected. She commented the staff's patience in placing capital and the flexibility the Board gives staff, provides a good position to take advantage when the pricing adjustment occurs.

The five-year net return of 9.3% for the core portfolio continues its strong improvement. The non-core portion of the portfolio is challenged because these investments are strongly driven by vintage year performance and if the vintage year is not a good one, there is not much to be done in the recovery of these assets and strategies on a go-forward basis. However, the portfolio is improving on a relative basis. The five-year net return of 5.3% is significantly greater than last year's five-year net return of negative 14.3%.

MS. MAGEE commented staff continues to remain risk-adjusted and risk-appropriate in their allocations, as well as the management of the portfolio, and the stability of returns continue support staff's decision-making.

MS. ERCHINGER asked if it was fair to say the portfolio did not benefit from dollar cost averaging from 2009 through 2013. MS. MAGEE agreed. MS. ERCHINGER asked if it was fair to say the portfolio may have been overweight in real estate and investments could not be made because of the target allocation. MS. MAGEE believes being overfunded in real estate was a problem for most pension funds and there was not capital to allocate. She believes there were opportunities and some of the best vintage years will be '09, '10, '11, and '12, simply because nobody was buying.

ACTING CHAIR HARBO recessed the meeting from 10:21 a.m. to 10:36 a.m.

C. ADOPTION: REAL ASSETS FY 15 PLAN & POLICIES
Board Discussion
Action: Real Assets FY15 Annual Plan
Res: 2014-14

MR. SIKES advised the first action relates to the fiscal year 2015 real assets annual investment plan. The recommendation is for no new allocations for core separate accounts or commitments to open-end funds. The core separate account advisors should continue to manage existing portfolios and allocations toward the core assets located in markets with high barriers to entry. Separate account managers should continue to take advantage of opportunities to sell non-strategic assets at attractive prices and improve the quality and income stability of the portfolio.

Under CIO discretion, staff plans to explore medical office investments, value-added and opportunistic real estate funds, and participating mortgage investments. Staff is recommending increasing the bands around the public real estate investment target from 10%, plus or minus 10%, to a target of 10%, plus 20% or minus 10%, to allow more capacity to use REITs in the management of the real estate allocation and the overall real assets allocation.

A corresponding adjustment would also be made to the private real estate target from 90%, plus or minus 10%, to a target of 90%, plus 10% or minus 20% on a band. No recommendations are proposed for farmland, timberland, infrastructure, TIPS, and energy strategies.

MS. ERCHINGER moved to approve Resolution 2014-14, adopting the real assets annual investment plan for fiscal year 2015. MR. BRICE seconded the motion.

COMMISSIONER THAYER moved to approve Resolution 2014-14 by unanimous consent.

There was no objection and the motion passed unanimously.

Action: Real Estate Policies and Procedures
Res: 2014-15

MR. SIKES advised the next action item relates to the real estate policies and procedures. There are three proposed changes. The first proposed change is to remove the constraint, which requires that controlled investments not exceed 85% of the real estate portfolio. The second proposed change is to remove the constraint, which requires core investments not exceed 85% of the real estate portfolio. Controlled investments and core investments are the most advantageous and least risky strategies and there should not be a restriction if portfolio objectives can be met by utilizing these strategies.

The third proposed change relates to the single manager investment limit increase from 35% to 45%, to create more individual capacity where multiple product lines help mitigate the single firm exposure to risk.

MS. ERCHINGER moved to adopt Resolution 2014-15, adopting the revised real estate investment policies, procedures, and guidelines. MR. PIHL seconded the motion.

MR. BRICE expressed his concern to increasing the allocation of an individual manager from 35% to 45%, and noted the Board will be tracking these concerns. MR. BADER explained the constraint is addressed at increasing the limit for a single managing firm and the approach staff is reviewing diversifies the portfolio construction into different sectors, utilizing different manager teams at UBS, for example.

MS. ERCHINGER reported the question was asked by the Committee if it was possible to increase the allocation to the sector, rather than increase the allowable manager percentage. She noted the answer was expressed this is not a viable option because real estate is over its target allocation.

COMMISSIONER RODELL believes diversification is an issue that needs to continue to be discussed, especially as the funds get bigger. She commented the passage of this resolution in no way obviates Trustees' responsibility to watch the diversification of the investments into the funds and the individual firms.

A vote was taken, and the motion passed unanimously.

8. UBS REAL ESTATE

MR. BADER introduced TOM ANATHAN, Managing Director UBS Realty Investors, and JEFF MAGUIRE, Senior Portfolio Manager UBS Realty Investors. MR. ANATHAN noted he was present in September of 1980 when the relationship began with the State of Alaska, utilizing the Trumbull Property Fund. UBS currently has $24 billion in total assets, with almost 190 employees. UBS is headquartered in Hartford, Connecticut, with very substantial offices in both San Francisco and Dallas. The mission is to provide superior risk-adjusted returns. MR. ANATHAN commented UBS worries about return and risk. He reviewed UBS' total asset allocation and geographic allocation.

MR. MAGUIRE explained the ARMB separate account began in 1998, providing 16 years of a total annualized gross return of 9.22%. As of June, the portfolio consisted of 11 investments, with a total value of about $317 million. The average property value is $29 million. There is $33 million of remaining allocation to be invested. The strategy for the portfolio has remained largely consistent over time, providing a true core real estate portfolio that provides current income, cash flow, inflation protection, and some diversification benefits. The current income and cash flow is distributed monthly.

MR. MAGUIRE continued his detailed presentation noting the acquisitions are mostly fully leased offices, industrial properties, and apartments, which were new at the time of acquisition. In 2003, some of the assets that formerly were managed by PM Realty were added to the portfolio, increasing the industrial weighting. Consistent with the objectives and guidelines for the account, no leverage has ever been used.

The objective for the account in terms of protecting against inflation and providing a real return is a 5% net real return over any rolling five-year period. Over the 16-year period, the account has exceeded its objective by 20%, with a 6.09% net real total return. MR. MAGUIRE reviewed the individual properties in the separate account.

COMMISSIONER THAYER requested additional information on the goals and status of the Memphis Industrial Park property and it being zero-percent leased. MR. MAGUIRE noted the account has had very good performance in the last three years, despite little contribution from the Memphis property. MR. MAGUIRE stated this is a difficult market and noted a prospect is interested in leasing the entire building, but does not want to jinx the possibility by discussing it further.

MR. MAGUIRE reported the separate account is a high quality core portfolio, with no debt and a history of strong income returns and income growth. He is encouraged by the potential of additional leasing and the projected growth in income this coming fiscal year is about 7% more than in the prior fiscal year.

MR. ANATHAN continued the presentation detailing the Trumbull Property Fund, which is a broadly diversified core portfolio providing a total return of well over 8.5% for yield since inception in 1980. The Trumbull Property Fund consists of gross assets totaling $17 billion. It is well diversified by property type and geographic region. Currently, 74% of the fund's assets are invested in properties worth $75 million and larger. One of the advantages this portfolio provides is investments that are generally too large for the ARMB's individual account. Leverage in the Trumbull Property Fund is at about 12.8%. This is a low risk strategy, very high quality and very large properties, with about half the leverage of the ODCE.

MR. BADER requested explanation of the ODCE. MR. ANATHAN explained the Open-end Diversified Core Equity Fund has a universe of 22 funds, a market value of more than $100 billion in total assets that report to NCREIF. Each quarter, NCREIF produces the performance of those 22 open-end funds. MR. ANATHAN explained another acronym, GRESB, Global Real Estate Sustainability Benchmark, has a universe of approximately 600 funds that report in on their environment and sustainability efforts, including measurements of energy efficiency, recycling, and property construction. The Trumbull Property Fund is the second highest ranked fund in the ODCE for its GRESB weighting. Other competitive advantages include its consistent core strategy, performance record, diversification into larger properties, and the team continuity and experience.

MS. ERCHINGER expressed her appreciation for the great presentation, excellent returns, and transparency of the fee structure.

9. SENTINEL REAL ESTATE CORPORATION

MR. BADER introduced DAVID WEINER, Vice Chairman/Co-Portfolio Manager, and DAVID STENGER, Vice President/Co-Portfolio Manager, both from Sentinel Realty Advisors Corporation. MR. WEINER noted Sentinel's long-term involvement with ARMB and its predecessors since 1984, and expressed appreciation for the wonderful relationship. MR. WEINER gave an overview of the corporation with current assets at $4.9 billion and a clear reputation for very stable management.

The ARMB's separate account has assets of $158 million and began in 2000. The since inception return is 9.2%. Sentinel primarily focuses on the multi-family area, managing about 30,000 apartment units across the U.S. The office and industrial portion of the portfolio consists of over eight million square feet of commercial real estate. MR. WEINER thanked the Board for awarding Sentinel the opportunity to manage a property that has been transitioned from another manager. He noted this property is 20 minutes from his home and will be closely watched.

MR. WEINER explained Sentinel, somewhat uniquely, manages all the assets of the portfolio internally. There is an executive staff of a couple hundred people and over 800 people onsite managing the properties. The portfolio is modest sized individual properties ranging between $40 million and $60 million. The investments are primarily in secondary and tertiary markets around the country. MR. WEINER believes opportunities exist in the 40 or so MSAs around the country with markets of over a million in population and provide better buying prices and strong performance. MR. WEINER commented on an overall basis, the level of supply and demand is very healthy going forward for the secondary, tertiary markets of modestly sized Class A, fully amenitized properties.

MR. STENGER continued the detailed presentation and specifically addressing the three properties in the account totalling 966 units, valued at $158 million. All three properties are located in the supply constrained smaller markets of Folsom, California, Chadds Ford, Pennsylvania, and Brandon, Florida.

MR. WEINER added the mandate from the staff is to look for properties in high barrier to entry markets, which essentially means limited new supply coming in the future. The portfolio reflects how critical it is to meet this requirement and the wisdom of looking at properties that have limited new construction. The property in Folsom, California was bought in July 2008, the peak before the financial crisis, and still has increased in value from $40 million to nearly $47 million today. MR. PIHL asked if this property is in the fire area of California. MR. WEINER noted it is not in the fire area of California.

PAUL ERLENDSON, Senior Vice President Callan Associates, expressed his appreciation for the presentation. He requested additional information on the competitive nature of acquiring multi-family properties in the current environment, and further information regarding exit strategies. MR. WEINER explained the market is competitive and it is necessary to maintain the investment discipline. There are three teams of acquisition specialists who have been with the company for an average of 20 years. These two-person teams scour the country in terms of looking for new opportunities in the market. The tight range, conservative overall corporate philosophy takes no development risk or joint venture risk.

MR. WEINER expects the Tampa market in this portfolio will be exited first, but will not be for a long time and until the new units are absorbed. Tampa has a good projection because it is a good coastal market with a growth port market. Exit strategies are being employed on a constant basis and consider what the market has to offer and what it costs to maintain the property. Every asset is acquired with some focus on how long it will be held and what exit strategy will be used.

MR. JOHNSON asked who the residents perceive as the landlord of these properties and is there the concept of pension ownership. MR. WEINER advised in most cases, even the onsite managers do not know who the owner is. Every property is supposed to operate in accordance with the Sentinel management procedures, maintaining high levels of occupancy, and adding to the cash flow. Sentinel does not reveal who the ultimate investor is in any of their accounts.

MR. PIHL requested comment on how comfortable Sentinel with the valuation of the Florida property. MR. STENGER noted the appraisals for this account are completed every March 31 by a third-party appraiser, who looks at sales comparisons in the market and similar properties that have recently traded. MR. STENGER noted Sentinel is very confident in the valuation. MR. WEINER commented that traditionally, value is achieved by generating cash flow and higher values are a reflection of better operations going forward. He noted what has been happening in the marketplace because of strong demand is what is called cap rate compression, which is lowering of the yield expectation and raising the prices.

MR. SHAW if Sentinel believes the home ownership chart downward slope will continue or trend back up. MR. WEINER noted the trend went up because the government started driving home ownership through its cheaper debt, but it has recovered back down to the historical level and there is no expectation it will trend back up.

ACTING CHAIR HARBO recessed the meeting from 11:47 a.m. to 1:17 p.m.

10. EXPERIENCE STUDY 2009-2013

A. Second Actuary Review

VICE-CHAIR TRIVETTE introduced LESLIE THOMPSON, Senior Consultant Gabriel Roeder & Smith, who provided a detailed presentation on the review of Buck Consultant's 2013 Demographics Analysis and the review of Buck Consultant's 2013 Economic Assumptions Analysis. Both study results are included in the Board packet.

MS. THOMPSON discussed the items that raised questions and would warrant additional discussion. She looked at the history of all the valuations to determine what change in assumption recommendations should be made. MS. THOMPSON expected to see in PERS, a cost due to termination because there have been losses every year. She expected to see a cost to rehires and salary scale. She expected to see a reduction due to COLA NPRPA because those are gains every year. She expected to see an increase in retirement. Those expected increased and decreases were not included in Buck's analysis.

MS. THOMSPON noted that most of the demographic assumptions were in sync with Buck's. She believes more discussion could occur regarding setting the mortality for the PERS peace officers closer to 110%. She understands this population is very small, which is the reason Buck is utilizing their method. MS. THOMPSON finds the assumptions to be generally reasonable. She was surprised the judges had a pay decrease, even though there is data supporting this. The two recurring issues, which have not yet been addressed by Buck, is the review of the eligibility for termination versus retirement, and the magnitude of the TRS rehire loss seems big in proportion to the number of rehires in the TRS report. Buck had no comments regarding this issue in their report. MS. THOMPSON noted she did not see any of the retiree medical claim cost recommendations made earlier in the year incorporated into the experience study.

MS. THOMPSON continued her presentation detailing the review of the economic assumptions. She informed the method Buck has presented for the investment return assumption analysis is a brand new style to her, called GEMS, and is different from what is being used in the public sector market. MS. THOMPSON expressed her appreciation to DAVE SLISHINSKY, Buck Consultants, for graciously spending time with her on the phone explaining the new software. However, she cannot comment either way on the validity or invalidity of the new method, because she does not fully understand it.

MS. THOMPSON believes the 8% return under the new model is high and merits deeper consideration. The chance of achieving that return is only 40%. Her calculations would bring the return closer to 7.5%. If the Board believes positive events will occur, then the return could be raised to 8%. She also believes it is also important to ask what the possible impacts to the model could be if longer-term liquidity requirements cause returns to be lower.

MR. BADER asked if MS. THOMPSON agrees if the Board can beat their indexes and maintain a very positive alpha, the 8% return is achievable. MS. THOMPSON agreed, and noted alpha cannot be accounted for in the actuarial standard. MR. BADER informed there has been very positive alpha over the last three years and has been more than enough to provide the 8% return assumption.

VICE-CHAIR TRIVETTE requested explanation of the impacts if an inflation rate of 3.0% was used rather than 3.12%. MS. THOMPSON noted the table on page six of her presentation shows that change, and her arithmetic expected return on 8.04% would drop to closer to 7.5%. MS. THOMPSON believes 3.12% inflation is high because the 20-year CPI and 40-year CPI have an arithmetic mean of 2.91% and 3.1% respectively.

COMMISSIONER RODELL asked how the chart on page four correlates to the chart on page six. MS. THOMPSON explained the charts are not direct comparisons because the investment consultants surveyed for page six have different time horizons, varying between 10 and 20 years.

MS. ERCHINGER expressed her appreciation to MS. THOMPSON for her analysis and presentation. MS. ERCHINGER requested spending more time on reviewing the assumptions and the endorsement of assumptions, not at this meeting, but before setting subsequent rates going forward.

MR. PIHL asked GRS found data in the review to support the 4.3 recommendation for salary increases. MS. THOMPSON informed MR. SLISHINSKY will have to answer, because she does not have the data. MR. PIHL noted his concern is the higher assumption increases normal costs, and therefore, contribution rates. At the same time, the higher increased assumption makes the payrolls grow to much higher levels and accentuates the backloading of contributions coming into the system, as the magnitude of the unfunded liability problems are being addressed. He recommended the unfunded liability issues and the conservative contribution recommendations could be separated somehow.

VICE-CHAIR TRIVETTE stated that he takes both of those comments to heart and will pass them onto the Chair. He agreed there needs to be more time in understanding this complicated experience analysis, especially since it is only compiled once every four years.

COMMISSIONER RODELL agreed with the comments and believes it would be helpful in the future to schedule a workshop before the ARMB meeting to delve into these issues in preparation for taking Board action the following days.

MS. ERCHINGER noted the Board did not receive the actual experience analysis and asked if MS. THOMPSON based her presentation on the full analysis. MS. THOMPSON agreed, and noted the experience analysis was 116 pages.

MS. THOMPSON believes Buck uses a mean optimizer model, not the GEMS model, for asset allocation, and if they used the GEMS model for asset allocation, the results would be different. She questioned the reasoning for using two different models.

MR. BADER informed DR. JENNINGS was having trouble on the phone and emailed his comments that actuaries will disagree, but he contends the best estimate is the most prudent. So-called conservative choices are statistically less likely than a midpoint estimate. He believes states have less reason to be conservative and have less of a need of a margin for adverse deviation. Instead, they should strive to be accurate. Dr. Jennings remains concerned about the high inflation estimate and believes the false precision of 3.5% will look unreasonable in hindsight.

VICE-CHAIR TRIVETTE took an at-ease from 1:45 to 1:48.

B. Experience Study Analysis

VICE-CHAIR TRIVETTE introduced MR. SLISHINSKY and CHRIS HULLA of Buck Consultants to provide their presentation on the experience study analysis and economic assumptions analysis. MR. SLISHINSKY expressed his appreciation to the Board and to MS. THOMPSON for her thoughtful audit and review or Buck's actuarial experience analysis.

MR. BARNHILL asked if there is a separate document, a final report, the Board has not received in addition to the documents that have been distributed. MR. SLISHINSKY explained all of the charts that are in the appendix to the current presentation are included in the final and formal experience analysis report, which is in process. MR. BARNHILL asked if the current presentation was all that GRS had reviewed. MR. SLISHINSKY agreed.

MR. SLISHINSKY stated his presentation today covers the purpose of the experience analysis, the methodology used, the actuarial assumptions, decremental assumptions, demographic assumptions, post-employment healthcare assumptions, recommendations for the Board, and the impacts of those proposed changes on the calculation of the liabilities, the unfunded liability, and the contributions.

The experience analysis is conducted every four years, and this particular analysis covers the four-year period beginning July 1, 2009, through June 30, 2013. The Judicial Retirement System and National Guard System complete valuations every other year in even years and so they have a one-year lag in their review period. MR. SLISHINSKY believes actuarial mathematics is a science, but its application in the real world is an art. The combination of looking at the analysis and then using judgment, given the experience and the credibility of the data, helps determine to what extent the belief that the future experience will be different.

VICE-CHAIR TRIVETTE stated he agrees with the approach of using a mortality table which is not static, and asked if adopting the use of Scale BB is appropriate, given that it is not in common use. MR. SLISHINSKY believes Scale BB is a more accurate table when compared with the data from the RP 2014 Table. Scale BB came out in 2012, and the data is pretty clear the table provide a better match to improvement that has been seen in the general public. He noted many systems do not make changes in mortality until they complete an experience analysis and there are still systems that have not completed an experience analysis since BB was published.

MR. SLISHINSKY explained the data for peace officers and firefighters indicated so few people were exposed to mortality and dying, that Buck did not feel the data was credible to set mortality rates. This is why the assumption rates were set equal to PERS Others. When the table is applied the assumption for males comes in at 82%.

COMMISSIONER RODELL requested further clarification regarding the 82% assumption rate for peace officers and firefighters as it relates to the GRS recommendation of 110%. MR. SLISHINSKY explained when the assumption is increased to 110%, that increases the life expectancy for males who are peace officers and firefighters to greater than PERS Others. The question arises, why should those peace officers and firefighters live longer than the general PERS Others group? The group is so small and the amount of data is not large enough to make a determination over the lifetime of the plan.

COMMISSIONER RODELL questioned if the reason the peace officers and firefighters are in a small sample group by themselves is because there is a risk attached to this category of work. MR. SLISHINSKY noted breaking them out in the analysis has always been done. Before retirement, during active duty, there are additional deal expectations due to the hazardous nature of the job, but once they retire, their life expectancy is typically the same as anybody else.

MR. BARNHILL commented this discussion supports the notion of having an educational workshop to review the analysis. He believes this particular set of assumption has a fair amount of conservatism built into it, which provides more confidence is what Buck is presenting.

MR. SLISHINSKY continued his presentation noting the withdrawal rates were generally decreased, which includes some conservatism in that withdrawal assumption. The termination rates are also conservative and will help offset any of the rehire losses being seen. The rates for both reduced retirement and unreduced retirement have increased. MR. SLISHINSKY commented this is the area where MS. THOMPSON expected to see the change in the rates would increase the cost, but experience is showing a slight decrease in the cost. MR. SLISHINSKY believes this is due to the different demographics used in each of the valuation periods. Slight changes are being made to withdrawal of contributions at termination to match the data. No changes are being proposed for price inflation and wage inflation. The merit portion of the salary scale is being increased.

MS. ERCHINGER noted the experience recently has been a high increase in salaries. She believes this is due to having a hard time getting qualified people to apply for jobs because there is not a guarantee defined benefit retirement plan. MS. ERCHINGER asked if this is being considered at all in setting the salary expectations. MR. SLISHINSKY noted the TRS salary assumptions are slightly higher for long-term, and the PERS has been showing salary losses.

MR. SLISHINSKY discussed the growth assumption for both PERS and TRS being reduced to .5% from 1%. VICE-CHAIR TRIVETE noted there are multiple reasons to argue back and forth on this issue, but believes it is ultimately a reasonable assumption.

MR. HULLA continued the detailed presentation reviewing the post-retirement healthcare valuations and stated no changes to the assumptions are being recommended.

VICE-CHAIR TRIVETTE asked if it is safe to say, even though three billion dollars is being added this year, the rates are going down partly because changing the methodology from the level dollar to level percent of pay produces a smaller annual contribution. MR. SLISHINSKY agreed and noted the rates also decrease because of the new methodology under HB 385 of amortizing over a new 25-year period. The rates also decrease when the funds earn more than the 8%, as well as when the three billion dollars come in. VICE-CHAIR TRIVETTE requested the calculations and impacts of each of those scenarios separately. MR. SLISHINSKY agreed to provide the calculations.

MS. ERCHINGER asked if the $3 billion additional funds were accounted for in any of the changes to assumptions. MR. SLISHINSKY noted the $3 billion was not considered in the calculations for changes to the assumptions. This analysis covers through June 30, 2013, and those contributions will come in FY15.

C. Economic Assumption Analysis

MR. SLISHINSKY informed the economic assumption analysis presentation will include a summary of the economic assumptions, a historical view of wage and price inflations, past investment performance, and a description of the new model being implemented. The PERS, TRS, and JRS assumption is 8% per year, and National Guard is 7% per year, because of the different asset allocation on National Guard. Price inflation is 3.12%. Wage inflation is price inflation plus productivity.

VICE-CHAIR TRIVETTE recessed the meeting from 3:21 p.m. to 3:30 p.m.

MR. SLISHINSKY continued his detailed presentation, noting the new GEMS model being implemented has been in existence for about 15 years. It has received more attention since the financial crisis because of its capabilities, specifically measuring fat-tail events and the way in which equities have been behaving.

MS. ERCHINGER asked if the analysis was run using the old methodology before subjecting it to a new methodology to see the difference in results. MR. SLISHINSKY noted an analysis using the old methodology was not run. MS. ERCHINGER believes it is important for the Board to know the difference of impact between the two methodologies.

MR. JOHNSON asked how the decision was made to utilize this new GEMS model and does MR. SLISHINSKY personally agree with its use. MR. SLISHINSKY explained he was not involved in the decision. In 2009, a group of Buck's investment consultants did not feel their current model was robust enough to factor in the kinds of changes in the markets they had been seeing. They went out into the marketplace in search of an alternative model to be used for asset liability modeling, which was realistic and made long-term sense.

This model is an econometric model. It considers the current economic environment, including GDP, unemployment, and macro economic measurements. Since Buck's use of this model, it has won two awards from "Insurance Risk" magazine as being the best ESG, Economic Scenario Generator. MR. SLISHINSKY agrees with its use and was the first at Buck to use it for experience analysis reviews and it is used in all of the asset liability modeling studies.

MS. ERCHINGER requested the Investment Advisory Committee continue to review the GEMS model and come back to the Board with their recommendation and if it is appropriate to use this model.

MR. PIHL requested further explanation of the proposed salary scale, including merit increases and CPI increases. MR. SLISHINSKY advised the chart is showing the total payroll growth, as well as the impact of new hires and retirements. A total stationary population picture is created of average annual earnings. There are people in that population who terminate, and the people who replace them receive merit increases. Additionally, new hires are hired at lower wages. The increases from year-to year is wage inflation and payroll growth.

MR. PIHL expressed his concern in addressing the unfunded liability and the impact of percent of pay, backloading contributions, on the growing payroll. MR. SLISHINSKY does not agree backloading is part of the valuation.

MS. ERCHINGER noted this is a closed plan and requested clarification of what new entrants are being discussed. MR. SLISHINSKY clarified the discussion is for total payroll, DB and DCR. The unfunded liability is being funded using total payroll. After all of the calculations, there is not a significant enough difference to warrant a change in the assumption.

MR. SLISHINSKY further reviewed in detail the economic assumptions analysis, noting the current asset allocation policy was used. There will be unique situations regarding the closed plans that will have to be addressed in the future. MR. SLISHINSKY recommended the Board begin thinking about those issues now. The systems do not have liquidity needs in the short-term, but it is important to have some kind of knowledge of addressing those issues for this analysis to be complete, especially for a mature plan. MR. SLISHINSKY showed the forecasted expected rates of return for the plans and merged them with the projected benefit payments to determine the present value of those future benefit payments. When the projected future benefit payments are taken to calculate the total liability, the future present value of benefits for PERS measures out to be $21.5 billion. This includes the accrued liability, as well as the value of future normal cost payments.

The GEMS liability is then calculated by taking those future cash flow payments and discounting them back at the geometric return projections, and in all cases, those liabilities are less than the liabilities being used with the current discount rates. There is no recommendation to change the current discount rate.

MR. BADER asked what is the lookback period used for the GEMS economic cycles. MR. SLISHINSKY noted it is a long period of time. He did not have a specific number of years. MR. BADER requested that information.

MR. PIHL requested the presentation state who the benefit payments are for, DB, DCR, or both. MR. SLISHINSKY advised the benefit payments are for DB employees only, but it includes pension and healthcare. The DCR valuations are run for occupational death and disability, and the retiree medical benefit.

MS. ERCHINGER asked to be shown where in the presentation are the impacts of eliminating smoothing, as of June 30, 2013, and fully realizing all of the previous unrealized gains in setting the rates. COMMISSIONER RODELL asked if page 39 of the presentation shows the difference between 69.24% current and 43.62% is removing the smoothing and the unrealized gains. MR. SLISHINSKY agreed and noted that also includes the change in the amortization. The change in the assumptions further increases it to 46.01%.

MS. ERCHINGER asked why the analysis uses market value and eliminating smoothing in the 2013 rates, but then recommends continuing smoothing in the future. She sees this as a disconnect. MR. SLISHINSKY explained the calculations are shown as of 6/30/2013. HB 385 goes into effect for the June 30th, 2014 valuation, at which time the required amortization of 25 years and the level percentage of pay will be adopted. The $3 billion contribution is in SB 119. The intent of the Legislature was to, 1) eliminate smoothing of the assets, and 2) eliminate the two-year lag. Buck's recommendation for implementing those changes is to go to market value as of June 30th, 2014, whereby immediately recognizing all of the deferred gains, but going forward, grade back into smoothing gains and losses over a five-year period, until a five-year smoothing basis is attained. The reason for not using market value each year is the impact volatility would have on the contribution rates.

MR. JOHNSON commented the Board needs to consider and make a determination on whether to implement the legislative intent as MR. SLISHINSKY is suggesting, to fully implement the intent, or not to recognize the intent. He advised the intent does not have the force of law.

MS. ERCHINGER requested information on the magnitude of the impact of eliminating smoothing and going to market value on June 30th. MR. SLISHINSKY agreed to provide that information. MS. ERCHINGER believes the contribution rates are being artificially set lower based on complying with the legislation, which pushes the contributions into the future. She thinks it is the Board's desire to push the least amount of contributions into the future as possible. MS. ERCHINGER noted these issues are worth talking about.

MR. SLISHINSKY summarized the recommendations, with no change to the current interest rate assumptions, no change to the payroll growth assumption, no change to the assumed rate of return of 8% for PERS, TRS, and JRS, or to the 7% in National Guard. With regard to the long-term liquidity needs, it is important for the Board to begin thinking in terms of the lifetime of the benefit payments and get a sense of the level of risk for long-term policy.

VICE-CHAIR TRIVETTE commented the Board has begun those serious discussions and it is in the forefront of their minds. He expressed his appreciation for the presentation given.

D. Action: Acceptance of GRS Review Report

MS. HARBO moved to accept GRS Review Report. MS. RYAN seconded the motion.

The motion passed unanimously.

Resolution 2014-16 - Acceptance of Experience Study and Actuarial Assumptions

MR. PIHL moved to approve Resolution 2014-16, Acceptance of Experience Study and Actuarial Assumptions. MS. HARBO seconded the motion.

MS. ERCHINGER asked when is the Board required to set the contribution rate to meet the needs of the formulation of the state budget. MR. BADER understands the OMB needs to have the contribution rates set at this meeting, because they are going into budget deliberations now.

MR. BARNHILL commented it is normally the Board's practice to set the rates on or before this meeting for the next fiscal year. The Board may consider at a later session or sessions, the various issues discussed at this meeting regarding the experience analysis and make adjustments to the experience analysis. Any adjustments the Board were to make, in terms of assumptions recommended by Buck would not roll to the FY16 rate, but instead, to the FY17 rate. These fairly complex set of actuarial assumptions may warrant more discussion.

MS. ERCHINGER expressed she has no problem approving this resolution. Her concern is the 2016 rates are potentially much lower than they should be and if those lower rates are used to build the budget, then the following year, if changes are made, the Legislature is in a challenging position of having to add perhaps a significantly higher dollar amount to the budget. MS. ERCHINGER stated she does not necessarily intend to support the resolution for the 2016 contribution rates exactly as written because of her concerns of artificially setting the rates lower.

MR. BARNHILL urged the Board to consider the impact of the appropriation of $3 billion on the fiscal status of the trusts in comparison to the ARMB's baseline scenario calling for the appropriation of approximately one billion for FY16. He believes the Legislature has done an extraordinary appropriation to forward fund.

COMMISSIONER RODELL expressed caution about talking about artificial rates. She believes all rates the Board adopts are done so with a base of knowledge and understanding of the reasons and assumptions being made. MS. RODELL thinks the actions that Buck has taken are perfectly defensible and believes there is clearly an understanding, from her conversations with the Governor, various legislators, and legislative committees, that this is something that is going to continue to move around. It is important to recognize contributions may be lower than expected, because of better experience, and other times, contributions may be higher because of worse experience. She will advocate adopting the contribution rates as proposed by Buck in the resolutions today.

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

11. FY16 CONTRIBUTION RATE SETTING

Action: Relating to FY16 PERS Contribution Rate
Resolution 2014-17

MR. BARNHILL reviewed the methodology the Legislature developed in adopting rates. The first step is to implement the statutory changes by resetting the amortization period to a closed 25-year period and to reinitialize that starting in FY15. The second step is the intent language to eliminate the two-year rate setting lag. Buck recommended taking the valuation data and actuarial assumptions and roll those forward through to the end of FY15 in order to eliminate the rate setting lag.

The next step is to eliminate the actuarial smoothing. The actuarial methodology has two pieces. One piece is that gains and losses are smoothed in over a five-year period of time. The second piece is the 80/120 corridor method, recognizing gains and losses outside of that corridor on a deferred basis. Buck recommended resetting the actuarial asset values to market value, as of June 30, 2014, and then reinstitute the five-year smoothing. Buck recommended eliminating the corridor method. The last step, by statute, is to conduct an experience analysis every four years. Buck conducted the experience analysis reviewed today and has recommended the adoption of some additional conservatism, particularly in the areas of mortality, salary, and termination.

The proposed FY16 rate for PERS Defined Benefit is 27.19%, which includes the defined contribution rate. The proposed FY16 rate for TRS is 29.27%, which includes the defined contribution rate.

MR. PIHL commented this resolution would place the state assistance for PERS and TRS at 256 million, which is roughly half of what the Governor's objective was at 500 million. He believes this is largely a result of extending the amortization period and the percent of payroll adoption. MR. PIHL noted he would support a resolution that specifies the rates are set in following legislative direction, and not that this is a recommendation of the ARM Board. Alternatively, the ARM Board could adopt these rates and also provide an additional recommendation to the Legislature.

MS. ERCHINGER believes the Board is put in a difficult position. She believes the Governor's Office and the Legislature has done a great job in getting the $3 billion injection into the retirement systems and cannot say enough to applaud those efforts. MS. ERCHINGER thinks the Board ought to endorse the rates proposed in accordance with the legislation, and also make a recommendation for an addition appropriation which would bring the total contribution for 2016 up to the $500 million. This is not intended to be disrespectful.

VICE-CHAIR TRIVETTE suggested focusing on the current resolution and then consider a process that would address MS. ERCHINGER's suggestions. He supports both processes separately. MS. ERCHINGER stated her intent was to propose an amendment to the resolution to be voted up or down by the Trustees. MR. PIHL agreed the issues need to be handled together.

COMMISSIONER RODELL stated she will not support an additional request up to 500 million. She understands and appreciates the positions of MR. PIHL and MS. ERCHINGER, but does not foundationally agree the additional 250 million is warranted at this time, considering all the changes and accounting for the $3 billion contribution. COMMISSIONER RODELL would rather see some of the effects and the experience of the changes first, and continue to work on this at a later date.

An at-ease was taken from 4:51 p.m. to 5:00 p.m.

VICE-CHAIR TRIVETTE informed, at the permission of the Board, Resolution 2014-17, relating to FY16 PERS contribution rate, and Resolution 2014-20, relating to FY16 TRS contribution rate, will be taken up at the meeting tomorrow.

Action: Relating to FY16 PERS RMMI Contribution Rate and FY16 PERS ODD Contribution Rate Resolutions 2014-18 and 2014-19

MR. BARNHILL noted Resolution 2014-18 pertains to the defined contribution rate for retiree major medical insurance, which will be set at 1.68%. Resolution 2014-19 sets the rates for the PERS Defined Contribution Plan for occupational death and disability, 1.05% for peace officers and firefighters, and .22% for all other PERS employees.

MR. BRICE moved to accept Resolution 2014-18 and Resolution 2014-19. MS. HARBO seconded the motion.

COMMISSIONER RODELL requested MR. BARNHILL provide more detail on the two resolutions on the floor. MR. BARNHILL complied and explained the ARM Board sets these rates every year according to a process called for in statute. The rate setting evaluation Buck completed is provided in the Board packet.

A vote was taken, and the motion passed unanimously.

Action: Relating to FY16 TRS Contribution Rate
Resolution 2014-20

Resolution 2014-20 will be taken up at the meeting tomorrow.

Action: Relating to FY16 TRS RMMI Contribution Rate and FY16 TRS ODD Contribution Rate
Resolutions 2014-21 and 2014-22

MR. BARNHILL explained Resolution 2014-21 and Resolution 2014-22 relate to the TRS Retiree Major Medical Insurance rate be set at 2.04%, and the TRS Occupational Death and Disability rate be set at zero percent.

MR. PIHL moved to accept Resolution 2014-21 and Resolution 2014-22. MS. ERCHINGER seconded the motion.

A vote was taken, and the motion passed unanimously.

Action: Relating to FY16 NGNMRS Contribution Amount
Resolution 2014-23

MR. BARNHILL stated Resolution 2014-23 is the recommended contribution amount of $734,560 for the National Guard and Naval Militia Retirement System, following the valuation by Buck.

MR. PIHL moved to accept Resolution 2014-23. MS. ERCHINGER seconded the motion.

A vote was taken, and the motion passed unanimously.

Information: JRS Contribution

MR. BARNHILL advised the final item on the agenda today relates to the Judicial Retirement System contribution rates. This is strictly informational and no action will be taken. This item rests within the jurisdiction of the Commissioner of Administration to set the rates and the information is then provided to the Board. The recommendation coming from the Judicial Retirement System roll-forward valuation is that rates be set at 39.66% for normal costs, with a past service cost rate of 42.82%, resulting in a total rate of 82.48%.

RECESS FOR THE DAY

VICE-CHAIR TRIVETTE recessed the meeting at 5:11 p.m.

Friday, September 19, 2014

CALL BACK TO ORDER

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

Trustees Harbo, Erchinger, Rodell, Thayer, Brice, Ryan, and Pihl were also present.

12. STRUCTURED ALPHA

MR. BADER introduced GREG TOURNANT, Portfolio Manager, JEFF SHERAN, Product Specialist, and MELODY MCDONALD, Relationship Manager, all of RCM/Allianz, who provided a detailed presentation on Structured Alpha 1000 Plus. MR. SHERAN explained this is an absolute return strategy utilizing the options market. This strategy is designed to deliver a return of 10% net of fees in excess of the return of the 90-day T-bills, regardless of market conditions. The intent is to generate this return profile in as risk-controlled and responsible fashion as possible, while navigating a wide range of market scenarios. The annualized standard deviation is 8% to 10%.

There is full transparency of the portfolio holdings, using simple listed daily priced instruments that are all exchange traded and unleveraged. The fee schedule is performance-based and is only collected if positive alpha is delivered in the portfolio. The strategy was launched in 2005, and now has a stable nine-person team. MR. TOURNANT is the lead portfolio manager and the creator of the strategy. Currently, there is about $2.6 billion in the strategy. This is a niche strategy inside of Allianz Global Investors and is the only options platform in the U.S.

MR. TOURNANT explained options are interesting and a source of potential alpha and this strategy captures many inefficiencies from the behavior of the market. Because the investment world is long equity, there is a natural demand for put options, protection to the downside, which tend to make the put options overpriced. The investment world has a tendency to be a seller of call options to generate additional premiums, and the call options tend to be under-priced.

Structured Alpha 1000 Plus is based on the principle the managers have no idea where the market or volatility is going and do not depend on that to generate returns from this strategy. MR. TOURNANT stated 80% to 90% of the time, the market behaves somewhat normally. From 10% to 15% of the time, the market can misbehave with an anomaly, some kind of market correction, a 10% move in just a few weeks, or the market crashes, which is an abrupt dislocation that occurs in one of two days. Structured Alpha is designed to protect capital when there are these anomalies, and at the same time, have positions that can make money if the market is normal. The focus is on capital preservation first, and return second.

The three building blocks of the diversified profit ranges are discount range-bound positions, directional positions, and hedging positions. These positions coexist in the portfolio at all times and rotate. The entire portfolio gets turned over approximately every seven to eight weeks. The Plus part of the portfolio is an additional protection module for severe dislocation and significant corrections in the market, as occurred in the fall of 2008 or in August 2011.

MR. ERLENDSON commented he finds this a fascinating strategy and particularly attractive is the low correlation. He asked if the low correlation is due to the contractual nature of the payoffs. His second question was why is it the confidence level in this strategy is so much higher than the competing strategies with high excess return targets. MR. TOURNANT explained the positions are structured to cover all kinds of scenarios, but the mathematically preferable profit zone is when the market goes down, because the new positions layered are much more attractive. MR. TOURNANT answered the second question by noting he has been comforted by the additional market participants using options. He has a high degree of confidence because of the extraordinary wide range of environments experienced within the last nine years.

MS. HARBO asked if the instant media and emotional reaction to the market has had any effect on how MR. TOURNANT conducts business. MR. TOURNANT informed options are only used on indices and not individual stocks. The behavior is more muted because the indices are a collection of stocks. Approximately 90% of the profit zones are kept to expiration, rather than emotionally react to news flows. They are monitored closely and it is a lot of work upstream to build a diversified set of positions.

MR. PIHL requested a projection of what kind of return would occur if there were a 20% market correction. MR. TOURNANT noted the answer in two parts. If the 20% correction is over six or eight weeks, the expectation would be flat to potentially positive returns. If the dislocation happens overnight or over a couple of days, the expectation is to be flat or down a few percentage points, depending on volatility spikes.

MR. SHAW requested a description of an environment that would not favor this strategy. MR. TOURNANT noted this strategy may fall short of the objective in an extraordinarily low volatility environment, and the return may only be 7% to 8%, as opposed to the 10% objective. Another unfavorable environment is one where a correction in the market took place, and volatility did not increase. This strategy is dependent on volatility to increase when the market goes down.

13. PERFORMANCE MEASUREMENT - 2ND QUARTER

MR. ERLENDSON introduced DANA BROWN, Senior Vice President, also of Callan Associates. MR. ERLENDSON and MR. BROWN gave a detailed presentation regarding the 2nd quarter performance measurement. MR. ERLENDSON expressed his appreciation to the Board for renewing this longstanding mutually successful relationship. The ARM Board has implemented a lot of creative investment solutions during a very challenging time and all the news is good. Inflation has been particularly low and the feds tapering program is coming to an end. The majority of the members of the Open Market Committee expect interest rates to start rising in 2015. Even though the growth in the economy is not significant, the view is it is sustainable.

MR. ERLENDSON stated that there has been a huge decrease in the unemployment rate, and at the same time, the labor force participation rate has also decreased. The idea is there are a lot of working age people potentially leaving the labor force and may be compelled to go back to school to learn new skills. The Chair of the Federal Reserve, Janet Yellen, is watching this as a key indicator.

The year-to-date numbers for the S&P, as of the end of August, were 9.9%, but as of September 12th, it is up on 9%. During the same time period, the Russell 2000 was up 1.8%, and has fallen to .06%. EAFE Index was up 2.6%, and has fallen to 1.4%. Emerging markets was up 11%, and has fallen to 8.4%. Bonds have also come off their year-to-date return as of August, to 3.6% for the Aggregate Bond Index and 4.2% for the TIPS Index. MR. ERLENDSON commented that although this retreating is not something anybody likes to see happen, it is normal in the capital markets. The trends in performance are the focus and the trends for this fund have been particularly good.

MR. ERLENDSON noted the GDP growth for Russia is projected to be slightly higher than the growth rate for Europe. However, most of the growth rates are at or below inflation rates for the different countries. As far as economic distribution in the U.S., the top three sectors account for almost half of the U.S. economy. These are information technology, financial services, and healthcare. He noted one of the smaller sectors of the economy, energy, was one of the best performers during the second quarter, and financial services, one of the large sectors, was one of the laggards during the second quarter. MR. ERLENDSON believes manager orientation, in terms of sector selection, will be a significant influence in terms of performance during this period of time. One of the drivers of the ARMB's non-U.S. positions will be the performance of currencies.

MR. ERLENDSON believes the sentiment is that short-term interest rates are going to see the bigger lift in interest rates going forward. The bond market going out 30 years is providing a return of 3%, which from a funding perspective, for this plan, is actually a cost factor from an actuarial perspective. The Board's reaction to this is through diversifying the fixed income by looking at absolute return strategies to try to minimize the interest rate sensitivity, while still generating cash flow.

MR. BRICE requested a comparison of the economic environment and the cost of Japan's bonds in relation to the cost of Greece's bonds. MR. ERLENDSON noted Japan has a functioning economy and are trying to make changes through economic stimulus, much like what saved the U.S. economy five to six years ago. Regarding bonds, one needs to look at not just who is issuing the most bonds, but what is their ability to repay those bonds with their balance sheet. Japan has the highest debt to GDP of any other country, at 180% of outstanding debt versus their GDP. Greece is second highest at roughly 150% outstanding debt versus their GDP. Italy is third on the list, roughly 109%. Many of the Western European countries have relatively high debt, but they have also had some strong performing equity markets, which is the great challenge managers and staff face.

The real estate returns, both private investments and publically traded real estate securities, have achieved rates of returns competitive to the mix of stocks and bonds, with the added advantage of dampening the volatility of the overall fund because they are not marked to market every day. This is particularly advantageous from a funding perspective. MR. ERLENDSON reviewed the calendar year chart for the commodity market. The challenge in working with commodities is that people tend to want to buy the things that are going up. However, the single biggest hazard the firm has seen with commodities strategies, is the manager needs to do the opposite of what their heart tells them to do, because the differences can be catastrophic and very difficult to recover. This is one of the reasons commodity allocations are unusual.

MR. ERLENDSON explained a chart showing the average rolling five-year returns for large public funds, which are larger than a billion dollars in size. The average five-year return since 1980 is almost 10% a year. It is important to continue to be effective in looking at the risks and opportunities in the future, rather than doing what worked yesterday. Since 2000, that same average five-year return has been less than 7% a year. MR. ERLENDSON believes it is useful to take a longer-term perspective in allocating capital that matches the timeframe of the liabilities. Pension funds have continued to add more and more different types of strategies to diversify.

MR. BROWN advised the trend of the overall performance is quite positive. The primary driver for that trend in the last year is positive manager effect, the active managers adding 1.36% of outperformance value. Staff has done a good job of rebalancing the allocation to keep very close to the targets.

COMMISSIONER. RODELL asked if the manager effect MR. BROWN is referring to includes Department of Revenue managers and externally hired managers. MR. BROWN agreed, and noted it would include the passive strategies, as well. The current positive trend continues over the most recent trailing periods relative to the benchmark, in the top quartile for the quarter, top decile over the last year, top quartile over the last two years, and top third over the last three years. MR. BROWN noted the portfolio is above or inline with the target allocation over longer time periods, but is not quite as positive as far as in the peer group.

The total bond performance has very good performance. It is an intermediate term portfolio and is designed to perform well in a rising interest rate environment. MR. BROWN explained there is no concern or worry regarding the recent underperformance of Mondrian. When they were hired back in 1997, they went through the same kind of period in 1998 through 2000, where they underperformed based on their philosophy and process. During 2000 through 2012, they dramatically outperformed. This is a defensive strategy and not expected to outperform in this kind of period.

MR. BROWN reported the two balanced funds' peer groups have been revised to better match their stock/bond mix. VICE-CHAIR TRIVETTE requested MR. BROWN and MR. ERLENDSON explain this is more detail to the DC Committee at a later point in time.

MR. BARNHILL asked for explanation of the five-year risk for the target date funds on page 45 in the presentation. MR. BROWN informed T. RowePrice manages the Glidepath and tends to be more aggressive and more volatile than their average peer, which is also one of the biggest drivers of their outperformance over time. There is no concern because it is consistent with their philosophy and process.

MR. BROWN continued the presentation explaining the analysis of money market funds has become almost meaningless because the Fed Funds rates have been basically zero for a very extended period of time and with zero returns net of fees, plus or minus one or two basis points could be the difference between third and fourth quartile. MR. BROWN noted there is discussion about alternate ways to reflect the money market analysis until they return to normal conditions with a positive real yield. VICE-CHAIR TRIVETTE requested the alternative way to conceptualize money markets be brought back to the Board, and asked if there was any concern. MR. ERLENDSON noted there is no concern and the short end of the yield curve is zero to 25 basis points. One of the options would be to only compare the money market funds to their stated benchmark and not to its peers.

MR. BADER believes it is important to educate participants that the money market funds are losing money to inflation. Participants may have placed their money in the money markets as a safe harbor and never left, but need to understand their savings is being eaten up by inflation. VICE-CHAIR TRIVETTE agreed.

MS. HALL noted a question from DR. JENNINGS, who is online, requesting comments on whether there is increased client interest in hedging international stock exposure. MR. ERLENDSON noted he has been hearing some interest in it, but the vast majority of the clients are still unhedged. The hedging question is left up to the discretion of the manager.

MR. PIHL asked if the increase in interest rates occur on the short end of the curve, does this mean bad news for short duration bond holdings. MR. ERLENDSON explained if interest rates increase, it is going to hurt bond holdings, but it is going to hurt less on the short end because reinvestment occurs much more quickly. It is a very common strategy to hold shorter maturity securities if there is fear of rising interest rates, so the capital can be reinvested into that higher market.

VICE-CHAIR TRIVETTE recessed the meeting from 10:24 a.m. to 10:42 a.m.

15. BOARD GOVERNANCE DYNAMICS AND CLOSING COMMENTS

VICE-CHAIR TRIVETTE introduced the next agenda item and noted it is out of order. MR. JOHNSON provided a detailed presentation of the history of the investment responsibilities of the retirement funds, beginning solely with the Commissioner of Revenue, to the creation of the ASPIB in 1992, including the Prudent Investor Rule, to the conversion from primarily a defined benefit to a defined contribution plan, to the creation of the ARM Board in 2005. MR. JOHNSON noted one can debate whether or not the Legislature has done the right thing in a lot of retirement-related issues, but he would propose the Legislature has done right in the composition of the Board, which has been a great benefit to the beneficiaries of the funds. Not withstanding the amalgamation of different talents and different perspectives of the Trustees, there remains the obligation to act as a fiduciary.

MR. JOHNSON believes the different perspectives of the various members brought to the table and the disputes that occurred, yielded a very productive line of discussion and thought process in determining the right solutions to benefit the system. MR. JOHNSON compared the ARM Board and ASPIB with the experience from some other public pension boards throughout the United States, and noted horror stories, acrimony, and pay for play genuine fraud, which Alaska is fortunate not to have experienced. He believes there has been significant tension in the differences in philosophy and approach, and it is important to provide a forum for these issues to be discusses because they affect so many people. At the end of the day, these differences have led to positive results and not to corruption. The role of respect has maintained throughout the conflicts.

MR. JOHNSON suggested the wisdom of collective discussion and deliberation is enhanced by the different perspectives and encouraged the Trustees to bring forth their particular perspective and views. As fiduciaries, the Trustees may collectively make an error in an ultimate determination, but if the decision was thought through, deliberated on, with a justifiable record of that decision-making set forth, nobody can be faulted for the ultimate error. This sound governance is enhanced by statutes with the Department of Revenue, by law, as the Board's staff. He noted the IAC was a brilliant idea by the Legislature and the Board has been well served by the IAC members.

MR. JOHNSON believes the Board will be well served by MR. GOERING, and as long as the Board continues to engage in thoughtful deliberations, rely on the consultants, seek assistance from all the folks who provide statutory input, the Board is in excellent hands.

MR. BRICE expressed his appreciation to MR. JOHNSON for his years of service, and asked what he views as the Board's biggest pitfall to be aware of in the upcoming years. MR. JOHNSON noted there is difficulty in presenting the Board's perspective on appropriations and contributions to the fund that are needed to meet the obligations of the fund. The challenge is in making recommendations that may or may not be accepted or acceptable to state government. It is important to make the recommendations and statements as collectively as possible.

MR. PIHL thanked MR. JOHNSON for his work for the Board and for the Department of Revenue. COMMISSIONER RODELL expressed her appreciation to MR. JOHNSON for all the help he has given over many, many years. VICE-CHAIR TRIVETTE thanked MR. JOHNSON for his service, and noted he watched MR. JOHNSON from the sidelines for years during the ASPIB timeframe, and found the remarks extremely beneficial, helpful, and thoughtful. On behalf of the general public, VICE-CHAIR TRIVETTE believes Alaska is a much better place because of MR. JOHNSON. MS. ERCHINGER expressed her appreciation to MR. JOHNSON for his service to the Board and for his public service in Alaska. She noted it has been a pleasure working with him for more than 20 years. MR. BARNHILL thanked MR. JOHNSON for serving as a colleague, a mentor, and maintaining a sense of humor, which made for very enjoyable meetings.

ACTION: Relating to FY16 PERS Contribution Rate
Resolution 2014-17

MR. PIHL confirmed, for the record, that the contribution rates MR. BARNHILL presented yesterday were prepared by Buck Consulting. In the past, Buck has presented the information to the Board, and yesterday, the information was recapped by MR. BARNHILL. MR. BARNHILL agreed and noted MR. SLISHINSKY, from Buck, is available to confirm the preparation.

COMMISSIONER RODELL moved to approve Resolution 2014-17. MS. RYAN seconded the motion.

MS. ERCHINGER submitted a proposed amendment to Resolution 2014-17, and noted it contains a mathematical error. The dollar amount $130,108,327 should be replaced with $124,119,164.

MS. ERCHINGER moved to amend Resolution 2014-17, and insert at the top of the page; "Consistent with the legislation enacted in 2014," then also prior to the dated line, as follows in one paragraph; "In addition, the Board recommends an additional appropriation to the Public Employees Retirement Trust Fund in the amount of $61,934,236, at the discretion of the Governor and the Legislature, with the intent of bringing the total amount of state assistance for PERS and TRS to the contribution amount projected by House Bill 385," and an additional paragraph stating; "In addition, the Board recommends an additional appropriation to the Public Employees Retirement Trust Fund in the amount of $62,184,928, at the discretion of the Governor and the Legislature, with the intent of bringing the total amount of state assistance for PERS and TRS to $500 million.

MS. ERCHINGER believes this amendment is consistent with the passage of the resolution requesting the $3 billion injection from the Legislature, as well as a steady $500 million contribution. MS. ERCHINGER stated the State of Alaska, the Legislature, the Governor, and the Governor's office, deserves huge respect and thanks for the work to unanimously pass the $3 billion contribution. MS. ERCHINGER noted COMMISSIONER RODELL rightfully corrected her yesterday for using the description of artificial rates. MS. ERCHINGER clarified her comments, informing she believes that rolling in all of the investment gains into one year, lowers the employer contribution rate in 2016.

MS. HARBO seconded the amendment.

MR. BARNHILL advised the Board has used the resolution process annually to adopt rates. Periodically, the Board has adopted resolutions requesting the Legislature to appropriate an additional sum of money. The Board has never combined the two. He brings this to the attention of the Board to consider whether it is appropriate and wise in this instance.

MR. JOHNSON recommended the part of the amendment which starts, "In addition, the Board recommends," would be a separate paragraph for clarification.

MR. BRICE commented he comes from the old school of one question to one motion. He likes the idea of asking for up to 500 million and believes more discussion is warranted regarding how the fiscal note relates to the Buck calculations.

COMMISSIONER RODELL requested MR. SLISHINSKY provide for the record, the funded ratio for PERS after considering the experience analysis, the $3 billion infusion, and the proposed rate of 27.19%. She believes it will be considerably healthier than a year ago. The Board has continued to meet the challenges of the trust funds. Secondly, the Legislature clearly indicated disagreement with the ARM Board's level dollar method. COMMISIONER RODELL stated she supported level dollar, but the percent of pay method is now in statute. COMMISSIONER RODELL informed she will be voting against the amendment. She will be voting for the 27.19% rate, and if this is combined into one resolution, she will have difficulty voting for the entire resolution.

MR. SLISHINSKY advised he prepared all the numbers included in the resolution. As of June 30, 2015, the funded ratio was projected to be 69%. After additional calculations in August, including the asset return for FY14, cash flows, and the proposed change in assumption discussed yesterday that increases the accrued liability, the funded ratio is projected to be in 2015 at 71.8%.

COMMISSIONER THAYER encouraged serious consideration for creating a separate resolution for the amendment and not combining the amendment with the current resolution. COMMISSIONER THAYER advised he will be voting no on the amendment because of his concern the numbers, which are in the hundred of millions of dollars, is not written down for review, and does not believe this reflects fiduciary responsibility.

MR. BRICE requested further thought to memorializing $500 million, because there may be a point in time the Board needs to request more than $500 million. MR. PIHL believes the $500 million is not memorialized and only applies to 2016.

MR. PIHL commented the legislative fiscal note is based on results from the impact of percent of pay. He believes the Legislature was misled regarding percent of pay versus level dollar, and the costs over the time to 2040. MR. PIHL requested the Board be provided the analysis of level dollar versus level pay, on the basis of the 2040 extension, the $3 billion infusion, and additional factors.

MR. BARNHILL informed MS. HALL distributed to the Board the scenarios presented to the Legislature at the close of the legislative session, dated April 18th. It came down to three different methodologies and Buck prepared three different scenarios for the Legislature to review and ultimately pursue one of those. The notion the Legislature was misled in any way is false. Every step was completed with the assistance of Buck Consultants with total transparency.

MR. BRICE asked if the intent of the resolution is to set rates or to ask for state assistance. MS. ERCHINGER responded the intent of the resolution is clearly to set rates, but does not believe the Board was given sufficient time to discuss the impacts of the assumptions being made and the Board is doing as best it can on a very short period of time.

A roll call vote was taken, and the motion to amend failed with Mr. Brice, Ms. Erchinger, Ms. Harbo, and Mr. Pihl voting yes, and Commissioner Rodell, Ms. Ryan, Commissioner Thayer, and Vice-Chair Trivette voting no.

MR. PIHL moved to amend Resolution 2014-17 to read as follows; Now therefore, be it resolved by the Alaska Retirement Management Board, consistent with the legislation enacted in 2014, that the fiscal year 2016 actuarially determined contribution rate, attributable to employers participating in the Public Employees Retirement System, is set at 27.19%, composed of the contribution rate for defined benefit pension of 14.43%, the contribution rate for post-employment, healthcare, of 8.15%, and the contribution rate for defined contribution pension of 4.61%.

COMMISSIONER RODELL seconded the motion.

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

A roll call vote was taken to approve Resolution 2014-17 as amended, and the motion passed unanimously.

ACTION: Relating to FY16 TRS Contribution Rate
Resolution 2014-20

MR. BRICE moved to adopt Resolution 2014-20. MS. HARBO seconded the motion.

MS. ERCHINGER informed she would not belabor the point by proposing the amendment before the Board today, given the wishes of the Board in the last resolution.

MR. PIHL moved to amend Resolution 2014-20 with the same wording amendment approved in Resolution 2014-17. MS. HARBO seconded the motion.

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

A roll call vote was taken to approve Resolution 2014-20 as amended, and the motion passed unanimously.

14. INVESTMENT ACTIONS

A. Allianz Structured Alpha 1000-Plus Mandate

MR. BADER read the email from DR. JENNINGS yesterday regarding the Allianz material and requesting an explanation why this is categorized as an absolute return strategy. MR. BADER stated this question was debated greatly within his office. The three main reasons were, 1) the manager calls this investment an absolute return strategy, 2) Callan calls it an absolute return strategy, and 3) it is consistent with the benchmarks used for absolute return.

MR. BADER paraphrased the next question from DR. JENNINGS, asking for an explanation of how the $200 million allocation to this strategy was determined. MR. BADER reminded the Board several of the most recent allocation have been $200 million. The portfolio is now over $20 billion and this allocation represents one percent, which staff believes is an appropriate number. There are currently approximately $958 million committed or invested in this asset class.

MR. BADER paraphrased the next question from DR. JENNINGS, requesting comment on the prior Allianz strategy related to calls previously held. MR. BADER explained the difference between the two investments. The program proposed today is a hedge program buying and selling options on index funds, including the SPDR and the Russell 1000 Index. The previously held Allianz strategy was an entirely different buy-write program, which bought calls on individual stocks. The previous strategy was terminated several months ago because staff had left Allianz and it was not reaching its benchmark.

MS. HARBO moved hire Allianz to manage $200 million in the Structured Alpha 1000-Plus portfolio, targeting 90-day T-Bills, plus 10% net, subject to successful contract negotiation fees. MS. RYAN seconded the motion.

COMMISSIONER RODELL requested further information regarding the determination of the benchmark of the 90-day T-Bill plus 10%. She requested explanation of the fee, which seems extremely high for the strategy, and what impact it will have to the performance. MR. BADER noted the fee is only assessed if it is earned. Staff believes it is consistent with the investment, which will somewhat insulate the portfolio when a downturn comes. MR. BADER explained the benchmark is the target of this fund. Allianz offers five different approaches using structured alpha each with a different target. Staff and Callan reviewed these and agreed to this approach.

COMMISSIONER RODELL requested additional clarification on both of her questions. MR. BADER explained the fund has to exceed the benchmark return of the 90-day T-bill plus 10% in order to receive their fee. He advised, at the end of the Callan report, there are eight to 10 pages reviewing these strategies and the primary comment is on the Structured Alpha 1000-Plus.

A vote was taken, and the motion passed unanimously.

B. Defined Contribution Branded Funds

MR. BADER advised the next item relates to the creation of an international equity fund and Brandes International benchmark fund. This presentation was made to the Defined Contribution Committee earlier in the week. Great West provided a presentation to the Board on the concept of Branded funds at the April meeting. Branded funds combine managers to create one investment option in the defined contribution program. This recommendation is to combine two managers, Brandes, the current international equity manager, and Allianz. The two managers tend to be somewhat uncorrelated and are a good match together.

MS. ERCHINGER moved to authorize the staff to implement an international equity fund and change the Brandes International Fund's performance benchmark to the MSCI ACWI Ex-U.S. Index. MS. RYAN seconded the motion.

MS. HARBO inquired if the expense ratio for the branded funds, the same or lower than the combination for Brandes International. MR. BADER stated negotiations with Allianz will be conducted. It is staff's intention to drive the rates as low as negotiations allow.

A vote was taken, and the motion passed unanimously.

C. Equity Guidelines: Resolution 2014-24

MR. BADER discussed the next item relates to investment guidelines for domestic, international, and alternative equity programs. Many of the items are being changed to provide consistency in terms of the presentation, capitalizing, and making it more readable. Items six, seven, and eight are the main changes that relate to the strategies already in place. This is acknowledging some of the investment already allowed for in contract. Staff does not believe there are any particularly controversial changes and this is to make the guidelines consistent with the practices staff is following and believe the Board has already approved.

MS. RYAN moved to approve Resolution 2014-24. MS. ERCHINGER seconded the motion.

COMMISSIONER RODELL expressed her concern over item eight in this resolution describing forward contracts, options, swaps, without limitation. She asked whether it is appropriate to have a combined investment guideline for domestic, international, and alternative equity programs, or would it be better to separate alternative equities with its own investment guidelines, given the nature of some of the instruments considered. MS. RODELL expressed concern there are no limitations in this resolution and wants the Board to understand exactly what will be allowed with this action. MS. RODELL communicated the importance of this resolution being consistent with the regulatory work, including the Dodd-Frank legislation, and the new federal level rules.

MR. BADER believes there are limitations within the resolution, particularly in number eight, where it states, "And swaps, if specified in the investment management agreement or determined to be fundamental to the manager's investment mandate or strategy." These will not be in conflict with the Dodd-Frank issues or regulatory items. Lengthy discussions have occurred with MS. LEARY and there is no intent to expand horizons on internally managed strategies.

COMMISSIONER RODELL noted her concern regarding some of the wording, including the phrase, "determined to be fundamental." There is no specification as to who is making the determination and how it is being constrained. She requested comments regarding this issue from the IAC and MR. JOHNSON. DR. MITCHELL stated he appreciates

COMMISSIONER RODELL's concern, but does not see a problem. MR. JOHNSON believes the language provided here is in the broadest frame. The investment management agreements will contain the specifics of what is allowed. This will be determined by the Department of Revenue.
A vote was taken, and the motion passed unanimously.

D. Private Equity Guidelines: Resolution 2014-25

MR. BADER informed the next item is a revision to the private equity policy with two changes. The first one is changing the current threshold rate of return from 13% to a floating percentage rate equaling the Russell 3000 Index plus 350 basis points. As market conditions change, the threshold would move higher or lower. The second change is replacing the fixed $125 million CIO investment delegation limit to read, "With respect to direct investment allocation targets set by the ARM annually, the CIO has the authority to commit up to an additional one percent of the total defined benefit plan assets." This is consistent with an approval the Board gave the CIO at the April meeting increasing the authority to $200 million, which is about the same as the one percent limitation on the $20 billion total portfolio.

MS. HARBO moved to approve Resolution 2014-25. MS. RYAN seconded the motion.

MR. BRICE expressed the same concerns he expressed in April regarding giving this much authority to the CIO. He prefers the Board be engaged in the investment discussions and reviews. MR. BRICE understands the need for expediency in certain situations, and believes the role of the Board is to oversee these $200 million large investments.

COMMISSIONER RODELL believes the Permanent Fund Corporation adopted a similar one percent total asset level delegation of authority a few years ago. As fiduciaries, it is incumbent on the Trustees to regularly revisit this issue, especially as the fund continues to grow.

MR. BADER emphasized to the Board the authority is intended to be used if there is a time constraint that makes it in the best interest of the fund to make that decision. He understands the concerns of the Board and intends to bring investments in front of the Board after Callan has gone through their review process.

A vote was taken, and the motion passed unanimously.

D. Audit of Performance Consultant

MR. BADER provided the revised action item and described the RFP process conducted.

MS. ERCHINGER moved to direct staff to engage in negotiations with Anodos Advisors to provide services to conduct the required audit of the state's performance consultants, and pending successful terms and approval of legal counsel, enter into a contract for their services. MS. RYAN seconded the motion.

VICE-CHAIR TRIVETTE reminded Trustees the principal in this firm is the same that was used in the previous audit and some of those same people were involved in two previous audits. Trustees were appreciative of their work. He supports this motion.
MR. JOHNSON recommended for the record, the Trustees state their agreement with the recommendation and make the findings in the determination.

VICE-CHAIR TRIVETTE agreed it is appropriate that Mr. Bader laid out what staff would propose as findings and suggested they be included as part of the record. There were no objections from Trustees.

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

E. Adoption of ARMB Policy Manual

MR. BADER explained the updating process of the policies and procedure manual was undertaken by COMMISSIONER RODELL, MS. LEARY, MR. BADER, MR. JOHNSON, MR. POAG, and MS. HALL. The editing process concentrated on revisions and edits to the statutory and regulatory references, as well as additions to descriptions and responsibilities that did not exist for the ASPIB. Also included is updated language referencing the passage of HB 385 and SB 119 during the 2014 legislative session.

<u>MS. ERCHINGER moved to adopt the updated and edited September 2014 Board of Trustees Investment Policy and Procedures manual.</u> <u>MS. HARBO seconded the motion.</u>

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

F. Information: Historical ARMB Returns

MR. BADER noted the requested historical rates of return have been provided in the Board packet. This is not a dollar weighted average. This is an average between the PERS and TRS without dollar weighting, showing the experience of the retirement funds for 30 years.

UNFINISHED BUSINESS

1. Disclosure Report

MS. HALL advised the Disclosure Report was included in the packet and there is nothing unusual.

2. Calendar

MS. HALL noted there is no change to the calendar for the rest of this year. A teleconference for the Audit Committee meeting in October will be set soon. The date of the September 2015 Fairbanks meeting was corrected to September 24-25, 2015.

3. Legal Report

MR. JOHNSON had nothing further to report.

NEW BUSINESS

None

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD

None

PUBLIC/MEMBER COMMENTS

None

INVESTMENT ADVISORY COUNCIL COMMENTS

DR. MITCHELL commented the Board has had two days of very serious presentations and discussions. He informed his remarks will be light and perhaps flippant, regarding important issues, hedge funds, economic forecasting, and risk. The comment was made yesterday the CalPERS was exiting out of its hedge fund investments and the ARM Board was maintaining its commitments to this category. DR. MITCHELL believes CalPERS is close to being a perfect contrary indicator, meaning as long as decisions are opposite CalPERS decisions, all will be just fine. It may be appropriate to increase the absolute return investments, since the time to hedge is when everything is going well and asset prices are high. There have been six consecutive years of gratifying stock market returns.

DR. MITCHELL believes neither governments nor private economists can forecast the economy at turning points with accuracy or consistency. That does not mean we should give up trying, but when economic forecasts are expressed from managers, actuaries, consultants, or members of the IAC, we should realized just how fallible those forecasts have been. DR. MITCHELL noted the investment world has been consumed by discussion of risk ever since 2009. He believes the simplest and best approach to risk is to be long-term. Steady investing leads to steady results and is also beneficial from a physiological point of view of lower levels of cortisol.

MR. SHAW provided a different perspective regarding CalPERS and noted its size of $300 billion in relation to the ARM's size of $20 billion. He noted CalPERS was thinking about a 10% allocation to hedge funds, which is $30 billion dollars, and even at $500 million commitments, that is 60 individual managers. He believes this was a large reason CalPERS decided to exit the asset class, along with the headline story of $135 million in fees. In a fund the size of the ARMB, it becomes more reasonable to participate, and MR. SHAW applauds MR. BADER for being in these asset classes.

MR. BADER commented back to a question from COMMISSIONER RODELL regarding the Allianz product fee of 30%. He clarified the 30% is over the Treasury rate and not over the Treasury plus 10. MR. BADER still feels this is a good investment and wanted the Board to know he misspoke on that earlier. No comments were made by the Board regarding his comments.

TRUSTEE COMMENTS

COMMISSIONER RODELL appreciated DR. MITCHELL's comments on forecasting. She thanked the Trustees and staff for their work during this tough meeting. MS. HARBO expressed her appreciation to MR. JOHNSON for being a really good friend and noted she will miss him.

VICE-CHAIR TRIVETTE commented when he voted not to support the amendment earlier in the meeting, it was frankly because there was so much information on the table, and he was not able to multi-task, run the meeting, read the amendment, add the new information from the three letters received this morning, all at the same time. VICE-CHAIR TRIVETTE informed he is going to ask the Chair to consider holding a special meeting to retake up the issue that had a tie vote today, because he would have voted in favor of the amendment, had he had a chance to read the materials ahead of time. He believes this will give the maker of the amendment time to provide it to the members. VICE-CHAIR TRIVETTE will also request the Chair attempt to receive additional information from Buck that was asked for at the June meeting, and distribute that to the Board.

VICE-CHAIR TRIVETTE discussed he spent a fair amount of time dealing with legislators and legislative staff on the $3 billion contribution, and he heard some very well-placed legislators talking about contributing $4 billion. He believes there is enough support to listen to the ARMB's request. VICE-CHAIR TRIVETTE noted it is the Board's obligation to educate the Legislature and ensure they understand the motion by MS. ERCHINGER.

MS. HARBO suggested requesting a meeting of the Legislative Committee before the December meeting. VICE-CHAIR TRIVETTE stated the intent is to do something very soon. MR. BRICE recommended dealing with one issue per resolution. VICE-CHAIR TRIVETTE agreed.

FUTURE AGENDA ITEMS

MR. PIHL requested discussing level dollar versus level percent of pay, with the updated schedule until 2040, at the December meeting. He believes it is the role of the Board to identify and advance recommendations to the Legislature that seek the lowest system cost.

ADJOURNMENT

There being no objection and no further business to come before the Board, the meeting was adjourned at 1:00 p.m. on September 19, 2014, on a motion made by MR. and seconded by MS. HARBO.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

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Corporate Secretary

ADJOURNMENT

There being no objection and no further business to come before the Board, the meeting was adjourned at 1:00 p.m. on September 19, 2014, on a motion made by MR. and seconded by MS. HARBO.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary