State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
MEETING

Location:
Fairbanks Westmark Hotel
813 Noble Street
Fairbanks, Alaska

MINUTES OF
September 24-25, 2015

Thursday, September 24, 2015

CALL TO ORDER

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

ROLL CALL

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

Board Members Present
Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Kristin Erchinger
Commissioner Sheldon Fisher
Commissioner Randall Hoffbeck
Tom Brice
Sandi Ryan
Martin Pihl

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

Department of Revenue Staff Present
Gary M. Bader, Chief Investment Officer
Scott Jones, State Comptroller
Pamela Leary, Director, Treasury Division
Judy Hall, Board Liaison
Bob Mitchell, Deputy Chief Investment Officer
Steve Sikes, State Investment Officer

Department of Administration Staff Present
Kevin Worley, Chief Financial Officer, Division of Retirement & Benefits (DRB)
John Boucher, Deputy Commissioner, Office of Management & Budget
Joy Wilkinson, Office of Management and Budget

Consultants, Invited Participants, and Others Present
Todd Kanaster, Buck Consultants
David Kershner, Buck Consultants
Dave Slishinsky, Buck Consultants
Steven Center, Callan Associates, Inc.
Paul Erlendson, Callan Associates, Inc.
Bo Abesamis, Callan Associates, Inc.
Jennifer Ponce de Leon, Columbia Threadneedle Investments
Greg Spradling, Columbia Threadneedle Investments
Stuart Goering, Department of Law, Assistant Attorney General
Stephen Concannon, Eaton Vance
Rodrigo Soto, Eaton Vance
Michael Weilheimer, Eaton Vance
Chris Cunningham, Townsend Group
Micolyn Magee, Townsend Group
Ben Gugliotta, T. Rowe Price
Tony Luna, T. Rowe Price

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. RYAN seconded the motion.

The agenda was approved.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS, AND APPEARANCES

CHARLES GALLAGHER, Chairman of Retired Public Employees of Alaska, Northern Region, welcomed and expressed appreciation to the Board for traveling to Fairbanks each year. MR. GALLAGHER informed his organization's size has almost doubled since last year. He believes this is due to the organization's effective work of paying attention to the ARMB.

MR. GALLAGHER was pleased with last year's financial results. He expressed appreciation to COMMISSIONER FISHER and COMMISSIONER HOFFBECK for their attention and open dialog in working with the Administration.

APPROVAL OF MINUTES: June 18-19, 2015

MR. BRICE moved to approve the minutes of the June 18-19, 2015 meeting. MRS. HARBO seconded the motion.

The minutes were approved.

REPORTS

1. CHAIR REPORT

CHAIR SCHUBERT reported the privilege of participating in the Governor's fiscal policy review meeting recently. She suggested the consideration of pension obligation bonds. This possibility may be reviewed at a future meeting.

2. COMMITTEE REPORTS

A. Actuarial Committee

MS. ERCHINGER reported the Actuarial Committee met twice since the last ARMB meeting. The meeting on August 14th was for the purpose of holding a pre-valuation conference. In attendance were the two actuaries, Buck Consulting and GRS, and representatives from Department of Administration and Department of Revenue. A timeline was established in order for the ARMB to take action to approve the rates. OMB informational budget deadlines were discussed and a process was coordinated between the actuaries. An early warning signal system was developed for the calendar.

MS. ERCHINGER stated the outstanding audit findings identified by the review actuary over the last two years were reviewed. There are four remaining items the Committee will continue to work on through the next valuation.

MS. ERCHINGER advised the Actuarial Committee also met on September 23rd to vote on the employer contribution rate resolutions, which will be presented before the Board at this meeting. Substantial discussion occurred at the meeting regarding the legislative intent on the elimination of asset smoothing. The Committee voted to reinstate smoothing going forward. This was not a unanimous vote. MS. ERCHINGER indicated the resolutions the Committee will bring forward today are predicated on the ARMB's approval of reinstating asset smoothing.

MS. ERCHINGER advised the actuaries were requested to run the results of both smoothing and not smoothing. The information can be made available to the Legislature for consideration.

CHAIR SCHUBERT asked if the Committee requested an opinion from Department of Law as to the legislative intent regarding smoothing. COMMISSIONER FISHER does not believe the Department of Law has been asked for an opinion. He voted against smoothing in the

Committee meeting, but has since conducted additional due diligence, and now believes smoothing is the most prudent decision. He will change his vote to support smoothing.

VICE-CHAIR TRIVETTE commented that MR. JOHNSON, about a year ago, discussed the legal aspects of legislative intent and noted it is not a requirement under law. VICE-CHAIR TRIVETTE believes the ARMB has done its best to get as much information as possible and will make a decision based on its fiduciary responsibility.

B. Audit Committee

MR. PIHL reported the full Audit Committee met on September 23rd. The meeting was very well-attended and included representatives from Department of Revenue and Department of Administration. MR. PIHL reviewed the status of the audits of the June 30th financial statements. The Treasury Asset audit is near completion, and there has been excellent advance preparation and cooperation by staff. The Department of Administration Retirement System audits will be completed in October.

MR. PIHL stated the Committee discussed GASB 68 and the financial disclosures on pension unfunded liability. The issue remains whether or not Alaska has a special funding situation regarding state assistance. COMMISSIONER FISHER commented the discussion was valuable and healthy. He noted KPMG was requested to evaluate and provide additional scheduling options at a future Committee meeting.

C. Budget Committee

CHAIR SCHUBERT informed the Budget Committee met on September 23rd. A thorough discussion occurred regarding the FY 17 budget. The Committee recommended the Board adopt the 2017 budget. This will be discussed under the Treasury Division report.

D. Defined Contribution Committee

VICE-CHAIR TRIVETTE encouraged all members get a copy of the Chief Pension Officer Report, DC Committee of the Retirement Board, dated September 23, 2015, created by KATHY LEA. The Committee has been working very closely with the Division to understand the last five years' worth of data, specifically regarding disbursements. The information shows 69% of all dispersals from SBS, Deferred Comp, and DCRP are Defined Contribution. Out of those people, 77% did not go to a DRB or Empower/Great West educational seminar. Of the dispersals, 49% were taken out as cash and not rolled into an IRA or other kind of plan. MR. PIHL indicated employees have 90 days after withdrawal to reinvest their money into a plan of their choice.

MRS. HARBO asked if the information shows whether or not the people who took a complete disbursement of Defined Contribution, also took a complete disbursement of SBS and Deferred Comp. VICE-CHAIR TRIVETTE stated that information was not presented.

VICE-CHAIR TRIVETTE stated more than half of the active employees are now under the DCR plan. He noted staff is working very diligently to improve services and improve education. The process of implementing the ability that all public employees can buy into the Deferred Compensation plan is ongoing.

MS. RYAN advised the surveys used to acquire the information provided are volunteer surveys from the system SurveyMonkey. She believes the general takeaway is we need better education. MS. RYAN expressed a concern quoting the specific numbers and putting them in the record because they are highly suspect. A volunteer survey by nature gets responses from people who have a vested interest in answering the survey, and the actual numbers should be viewed with skepticism. VICE-CHAIR TRIVETTE commented DRB is aware of these concerns and is reviewing other survey options. The main focus is to improve services and education.

VICE-CHAIR TRIVETTE reported the Committee had a presentation by LORI LUCAS, Certified Financial Analyst and DC Practice Leader of Callan, regarding best practices. The Committee agreed to have ongoing discussions with staff, and possibly contract with Callan, to provide an assessment of the Alaska plan's strengths and weaknesses. VICE-CHAIR TRIVETTE indicated the Committee members are dedicated to the commitment of making the plan better for future generations.

3. RETIREMENT & BENEFITS DIVISION REPORT

A. Membership Statistics (informational)

Chief Financial Officer of the Division of Retirement and Benefits KEVIN WORLEY noted the informational membership statistics were provided in the packets. From June 30, 2014 to year-end June 30, 2015, PERS DB had a decrease of 1,486 members for a total of 17,988 active members; PERS DC had an increase of 1,464 members for a total of 17,476 members; TRS DB had a decrease of 376 members for a total of 5,606 members; TRS DC had an increase of 426 members for a total of 4,076 members; and retirees and beneficiaries increased to a total of 44,135, which equals approximately 32,000 for PERS and 12,000 for TRS.

MRS. HARBO asked if there are statistics on whether or not the 1,700 PERS DC people who took their funds out of the system also took their funds out of SBS and Deferred Comp. MR. WORLEY stated a report could be compiled to cross-reference that information. He noted the funds cannot be tracked once they leave Empower/Great West.

B. Buck Consulting Invoices (informational)

MR. WORLEY noted the Buck Consulting invoices informational worksheets were provided. The full year's worth of invoices have been broken down and reviewed by quarters.

MS. ERCHINGER requested additional explanation regarding calculation of termination costs for scenarios for a particular entity. MR. WORLEY explained according to statute, the cost of termination studies is borne by the employer. There was a particular item discussed with Buck Consultants and it was determined no termination study was necessary. Those costs were covered by the Division.

4. TREASURY DIVISION REPORT

A. FY 17 Budget - Action

Treasury Division Director PAMELA LEARY informed the two documents included in the packet, Fiscal Year 2017 ARMB Working Budget, and proposed management and custody fees, were reviewed with the Budget Committee on September 23rd. MS. LEARY believes the FY16 and FY17 budgets have sufficient amounts to cover the current plan status of operations. The management and custody fees are the two largest line items. The numbers are derived by assuming the same component managers, taking the current asset values through June 30th, 2015, and projecting them forward to 2016 and 2017, using the 8% target rate of return. MS. LEARY noted the document includes room for the possibility of up to $3 billion of pension obligation bonds, if authorized in 2017.

MS. LEARY noted the action item includes increases for personal services purchased from the Treasury Division for FY17. MS. LEARY advised Budget Committee and staff recommends the ARMB adopt the FY17 proposed budget, with the understanding that components will be subject to appropriation by OMB and the Legislature.

<u>MRS. HARBO moved to adopt the FY17 Proposed Budget as attached, with the understanding that components will be subject to appropriation by OMB and the Legislature. VICE-CHAIR TRIVETTE seconded the motion.</u>

MS. ERCHINGER commented she is not on the Budget Committee, but did attend the meeting, and acknowledged the ARMB will be recommending the budget to the Administration, who will pass a budget including additions or deletions deemed appropriate. MS. ERCHINGER noted for the record, the ARMB has not vetted the issue of potential funding for pension obligation bonds (POBs), nor is the ARMB involved in that conversation.

GARY BADER, Chief Investment Officer, stated the Board passed a resolution, preceding the membership of some of the members of the Board, that endorsed POBs. MR. PIHL recollected that resolution was in support of POBs as an option for management to consider. CHAIR SCHUBERT believes the Board authorized the issuance of POBs, should management decide to utilize that tool. MS. ERCHINGER requested a copy of that original resolution for clarification of this complicated topic. CHAIR SCHUBERT suggested a review of the original resolution in support of POBs take place later on in the meeting.

MRS. HARBO commented she is looking forward to seeing the vacancies filled at the Treasury Department, and believes the in-house management of funds provides a significant savings in management fees.

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

5. CIO REPORT

MR. BADER reviewed the CIO Report included in the Board's packet. Six transfers were made to the Blue Glacier Fund and three transfers were made to the Polar Bear Fund. One transfer document is included in the packet as an example and each transfer is available for examination in the office, should Trustees request further review. MR. BADER reviewed the investment guidelines were modified several meetings ago and these transfers are part of that continuing effort. The Board-approved investments to Zebra Micro Cap and KKR Apex Equity were funded.

MR. BADER reported the reduction in small cap allocation of $200 million in August was spread across several managers. The Large Cap International allocation was reduced by $100 million and put into cash.

MR. BADER advised Capital Guardian International Equity Fund has lagged in performance over recent years. MR. BADER requested the Board make a motion to place Capital Guardian International Equity on the watch list.

<u>MRS. HARBO moved to place Capital Guardian International Equity on the watch list. MS. RYAN seconded the motion.</u>

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

MR. BADER reviewed the next item and requested the Board remove McKinley Capital's Large Cap Domestic Growth Fund and International Growth Fund from the watch list. Their performance has recovered to initial expectations.

<u>MRS. HARBO moved to remove McKinley Capital's Large Cap Domestic Growth Fund and International Growth Fund from the watch list. VICE-CHAIR TRIVETTE seconded the motion.</u>

COMMISSIONER FISHER noted for the record he was the Chief Operating Officer of McKinley Capital immediately before joining the state, but has no current financial interests in McKinley Capital. CHAIR SCHUBERT believes COMMISSIONER FISHER may vote. STUART GOERING, Department of Law, Assistant Attorney General, agreed that if COMMISSIONER FISHER does not have a current financial interest, his disclosure at this meeting is adequate.

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

MR. BADER reported on the rebalancings of the portfolio. MR. BADER gave an update on Guggenheim Investment Partners and the settlement with the Securities and Exchange Commission (SEC). The ARMB holds a municipal bond strategy with Guggenheim. MR. BADER informed he will be conferring with counsel and Guggenheim regarding these issues and will provide a report at the December Board meeting.

MR. BADER notified the Board the approved investment with Fidelity Real Estate High Income Fund will be treated as a purchase of a security and therefore, will not have any contract documents. MR. BADER noted BOB MITCHELL, Deputy Chief Investment Officer, will address this later in the meeting. MR. BADER informed the Board he requested MS. LUCAS provide a list of improvements for the Defined Contribution plan. MR. BADER intends to review the list with COMMISSIONER FISHER to determine which items can be addressed in-house and which items to request Callan address. This effort will be brought before the Board in December.

6. FUND FINANCIAL REPORT with CASH FLOW UPDATE

State Comptroller SCOTT JONES and MR. WORLEY presented the Fund Financial Report. MR. JONES reviewed the financial statements for the 12 months ending June 2015. The approximate numbers are: the PERS system ended with $16.4 billion, the TRS system with $8.2 billion, the JRS with $171 million, the National Guard and Naval Militia (NGNMRS) with $37 million, SBS with $3.4 billion, and Deferred Comp with $806 million, for a total of $29 billion, of which $24 billion is non-participant directed assets and $5 billion is participant-directed assets.

MR. JONES stated the change in invested assets over the whole year was about 11.73%, and much of that was due to the $3 billion infusion into the TRS and PERS Systems. All asset allocations were within the bands and close to the targets.

MR. JONES informed the plans were flat in July, down in August, and down in September. The total non-participant directed assets as of September 18th were about $22.94 billion, with PERS at $15.2 billion, TRS as $7.6 billion, JRS at $164 million, and NGNMRS at $35 million. No current total was provided for the participant-directed assets.

COMMISSIONER FISHER requested additional information regarding the returns of the NGNMRS and why they do not correlate with the PERS and TRS. MR. BADER informed the NGNMRS is funded and invested completely differently from PERS and TRS. The investment options and asset allocation for NGNMRS is more modest than for PERS and TRS.

MR. WORLEY reported the FY16 appropriations are scheduled to occur on September 30th for PERS, TRS, and NGNMRS.

MRS. HARBO expressed appreciation for the additional pages of notes in the DRB Supplement to the Treasury Report. VICE-CHAIR TRIVETTE informed he will request line items to include in this report after the meeting.

7. ACTUARIAL RESOLUTIONS

A. Recommendation re: Asset Smoothing
Resolution 2015-07

MS. ERCHINGER provided a detailed review of the robust discussion by the Actuarial Committee regarding legislative intent and asset smoothing. After strong debate of the Committee regarding this issue, the Committee recommends approval of Resolution 2015-07, which asks the actuary to perform the June 30, 2014 actuarial valuations for PERS and TRS using market value, and from that point forward, adopt five-year smoothing with the phase-in methodology.

<u>MS. ERCHINGER, as Chair of the Actuarial Committee, moved to adopt Resolution 2015-07. No second needed.</u>

MR. BRICE commented the Committee has undertaken large amounts of review, discussion and debate on this issue. He supports the resolution.

COMMISSIONER HOFFBECK stated he supports the resolution. He believes it is critical to recognize there will be some push-back and would like to have the supporting documentation to show the Legislature how this utilizes best practice. MS. ERCHINGER informed the actuaries ran scenarios with smoothing and without smoothing. That information is available.

MR. PIHL stated he opposes the resolution, and believes the Legislature was fully aware of their intent to eliminate smoothing.

CHAIR SCHUBERT commented the recommendation was made in conformance with a Board resolution that is in effect and has not been repealed. She noted the Legislature, while expressing its intent, did not change the law concerning this. CHAIR SCHUBERT believes it is appropriate to move forward with the recommendation.

A roll vote was taken, and <u>the motion passed,</u> with Mr. Pihl voting against.

B. FY17 Contribution Rate Setting

MS. ERCHINGER advised Resolutions 2015-08, 09, 10, 11, 12, 13, and 14, are contribution rate resolutions consistent with the action to reinstate asset smoothing.

Action: Relating to FY17 PERS Contribution Rate
Resolution 2015-08

<u>MS. ERCHINGER, as Chair of the Actuarial Committee, moved to approve Resolution 2015-08. No second needed.</u>

CHAIR SCHUBERT noted the Board has a resolution in place concerning asset smoothing. She requested explanation of the use of the term reinstatement. MS. ERCHINGER explained SB 385 stopped asset smoothing when the actuaries rolled in all of the investment gains up to that point and reset the amortization period and method. MS. ERCHINGER clarified the term reinstate to mean asset smoothing will be used going forward.

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

Action: Relating to FY17 PERS RMMI Contribution Rate
Resolution 2015-09

MS. ERCHINGER, as Chair of the Actuarial Committee, moved to approve Resolution 2015-09. No second needed.

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

Action: Relating to FY17 PERS ODD Contribution Rate
Resolution 2015-10

MS. ERCHINGER, as Chair of the Actuarial Committee, moved to approve Resolution 2015-10. No second needed.

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

Action: Relating to FY17 TRS Contribution Rate
Resolution 2015-11

MS. ERCHINGER, as Chair of the Actuarial Committee, moved to approve Resolution 2015-11. No second needed.

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

Action: Relating to FY17 TRS RMMI Contribution Rate
Resolution 2015-12

MS. ERCHINGER, as Chair of the Actuarial Committee, moved to approve Resolution 2015-12. No second needed.

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

Action: Relating to FY17 TRS ODD Contribution Rate
Resolution 2015-13

MS. ERCHINGER, as Chair of the Actuarial Committee, moved to approve Resolution 2015-13. No second needed.

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

Action: Relating to FY17 NGNMRS Contribution Amount
Resolution 2015-14

MS. ERCHINGER, as Chair of the Actuarial Committee, moved to approve Resolution 2015-14. No second needed.

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

Information: JRS Contribution

JOHN BOUCHER, Deputy Commissioner, Office of Management & Budget, explained the Legislature has established a procedure whereby the normal cost for the JRS and the past service cost must be separated into two different line items. The total employer contribution rate is estimated at 76.4% for the fiscal year, with the past service cost representing about 35% of that total, approximately $5.4 million. The Department will be crafting the appropriate letter to provide to OMB.

MS. ERCHINGER stated that DAVE SLISHINSKY of Buck Consultants is preparing for retirement. She wished him well during retirement and expressed the Board's appreciation for his years of service. CHAIR SCHUBERT echoed the appreciation.

CHAIR SCHUBERT recessed the meeting from 10:25 a.m. to 10:40 a.m.

9. SECURITIES LENDING

CHAIR SCHUBERT informed T. Rowe Price representatives have not yet arrived and the order of the agenda will continue with 9. Securities Lending, then 8. T. Rowe Price.

MR. BADER introduced BO ABESAMIS, Executive Vice President of Callan Associates, Inc., who provided a detailed presentation on best practices within a securities lending program. MR. BADER reminded the Board the securities lending program was suspended in 2008, which turned out to be a timely recommendation when markets fell. MR. BADER believes the ARMB is in a position now to consider every possible way to earn money for the fund, without taking an unreasonable amount of risk.

MR. ABESAMIS explained securities lending is a critical tool in capital markets, where securities are temporarily borrowed by one party, the borrower, from another party, the lender. Securities lending has to be managed in a careful manner and the risk components must be understood before proceeding. The reasons for borrowing securities include, avoiding trade fails or overdrafts. Hedge funds also borrow securities in order to effectuate their short selling strategy for arbitrage purposes. The Federal Reserve conducts securities lending to effectuate monetary policy in the repo and reverse repo market. Exchange traded funds (ETFs) are created through the power of securities lending.

MR. ABESAMIS discussed the two components of revenue to securities lending. Intrinsic value is how much a broker/dealer is willing to pay to secure access to the security. The second component of securities lending revenue is reinvestment of the cash collateral received. MR. ABESAMIS showed a graphic of the plan sponsors who lend securities. Retirement and pension funds are the biggest source of securities out on loan. In 2008, close to $4 trillion of securities were out on loan. Today, there is less than $1 trillion of securities out on loan.

PAUL ERLENDSON, Callan Associates, requested information regarding how the securities lending market has changed. MR. ABESAMIS stated there is more focus on intrinsic value-driven securities, U.S. Treasuries, microcap, small cap, and international equities. When the securities are lent, the proxy vote is relinquished, but other economic benefits of ownership remain, including the dividend, corporate action, stock split, M&A activity, and interest payments. If the beneficial owner wants to proxy vote, the loan must be terminated and the security recalled.

MR. ERLENDSON inquired about collateralization rates and negotiations. MR. ABESAMIS continued his presentation explaining the lending agent negotiates and administers the loans and determines collateral amounts. The disciplined institutional investor who is getting back to securities lending needs to pay attention to intrinsic value and does not want to chase returns on the reinvestment. MR. ABESAMIS informed securities lending is highly regulated. He provided a thorough review of the regulatory and reporting guidelines from Department of Labor, Federal Financial Institute Examination Council, Federal Reserve, GASB, SEC, Dodd Frank, FASB, and IRC.

MR. ABESAMIS discussed the potential risks associated with securities lending. Borrower default risk means the borrower does not return the securities. The recourse for this is borrower default indemnification by the lending agent, who will either use substitution to replace the securities, or pay cash at a later date for the securities, which changes the allocation of the portfolio. DR. JERROLD MITCHELL asked which of these risks were most detrimental during the financial crisis. MR. ABESAMIS explained collateral reinvestment risk was the most detrimental. It is the risk that the investment of the cash collateral will not earn a sufficient return to cover the agreed upon rebate rate due to interest rate risk, liquidity risk, and credit risk. Other risks discussed were operational negligence, trade settlement risk, and country and currency risks.

COMMISSIONER FISHER requested additional information from the perspective of the investment manager and impact of overall fund performance. MR. ABESAMIS stated the investment managers could be impacted, especially if they cannot recall the security. He believes managers should lend no more than 20% of any position in the portfolio.

MR. PIHL inquired about the role of currency value in this program. MR. ABESAMIS explained cross-currency lending, purchasing power parity, and the international Fisher effect that impacts currency movements. MR. ABESAMIS reminded the Board the subject of securities lending is complicated and is taught as a semester class at Columbia and Princeton for a full semester.

MR. ABESAMIS explained how today's securities lending environment is a different structure than pre-2008, and plans now focus on intrinsic value and risk-managed approaches to securities lending. The most conservative risk adverse program would lend a security to generate 50 basis points, minimum, of demand spread, and reinvest all of the cash collateral in U.S. Treasury overnight repo, fully match, to manage the cash collateral reinvestment risk.

MR. BRICE asked how this type of strategy would respond during the recent readjustments in the market. MR. ABESAMIS indicated the turmoil over the past few months has contributed to the increase of lending activity because of the opportunities emanating from volatility. He stated a concern that this lending activity could create some sort of an increase in further volatility.

8. T. ROWE PRICE - Stable Value Fund

CHAIR SCHUBERT introduced JOHN PLOWRIGHT, Institutional Client Service, TONY LUNA, Head of Stable Asset Management Team, and BEN GUGLIOTTA, Associate Portfolio Manager, from T. Rowe Price. MR. LUNA has been with the firm for 20 years in the Fixed Income Department and works day-to-day on the portfolio management with MR. GUGLIOTTA, who joined the firm in 2010. MR. GUGLIOTTA has a degree in economics, a JD in law, and works on the wrapper contracts, which are an integral part of the strategy. MR. LUNA provided a detailed PowerPoint presentation entitled Stable Asset Overview. He noted the T. Rowe Price Stable Value business is approximately $20 billion. The Stable Value Fund comprises approximately $12 billion, and is one of the largest and oldest stable value funds in the country. The 13 separate accounts comprise approximately $7.5 billion. Two of the separate accounts are Alaska portfolios.

MR. LUNA explained a soft closed was placed on the fund in 2009 because investment capacity was drying up, and the fund reopened in 2014, as investment capacity came back. Capacity was found and preserved during this time for the Alaska plan. MR. LUNA mentioned TED WIESE, former Head of Stable Value and Low Duration, was promoted to Head of Fixed Income. This is important and efficient to have a member of the investment management committee at the firm level with stable value knowledge.

MR. LUNA reviewed the stable value portfolio structure. A wrap contract is responsible for catastrophic insurance, which bridges the gap if the liability is higher than the asset. The wrap contract smooths volatility over time. The wrap contract provides a 0% floor to preserve principal. The asset allocation includes a cash portion, an intermediate aggregate term bond portfolio, and a custom bond portfolio. The custom bond portfolio was introduced in 2013, is wrapped by RBC, and is run shorter than the intermediate bond portfolio. The four considerations for asset allocation are client objectives and risk tolerance, cash flows, demographics, and interest rate/yield curve position. MR. LUNA indicated SBS has a much different cash flow pattern than the 457 Plan, and thus the durations run differently.

MR. SHAW asked if the catastrophic insurance has ever been paid off and requested additional discussion. MR. LUNA does not believe the catastrophic insurance has ever been paid within the industry, even through the financial crisis, because employer initiated events are not covered. This is more of a concern for corporations, who can have spinoffs and mergers, than for state plans, but it is important to have communication between the manager and the client.

MR. LUNA reviewed the performance of the 457 Interest Income Fund and the SBS Stable Value Fund. The objective is to capture 80% of the Barclays U.S. Intermediate Aggregate

Index. The funds outperformed over one, three, and five years, and captured 90% of the returns for the 10-year.

MR. BADER inquired about the available amount of assets necessary to have sufficient diversification and wrappers in a stable value fund. MR. LUNA indicated the normal offering for a separately managed portfolio is $100 million. The SBS portfolio started lower than that and is currently $350 million. MR. LUNA explained thresholds below $100 million have the challenge of diversifying the bond portfolios. Comingled products called building block trusts can be utilized to diversify smaller clients and further discussions could occur.

MR. LUNA presented one of the goals as plan sponsor is to provide a premium of 150 to 200 basis points over money markets. This was easily met. The performance over the last five years has been very strong. MR. LUNA stated the projection is the Fed may raise rates, but believes the curve will stay steep. If the curve is sloped, providing lower rates for longer periods of time, the stable value should continue to outperform.

MR. ERLENDSON requested to know how to evaluate stable value performance success or failure, since peer-to-peer comparisons and benchmarks are less than perfect fits. MR. LUNA noted one metric is comparing the yield being offered relative to peers. The second metric is market-to-book comparisons of assets to liabilities. The industry average right now is 101 and the Alaska separate accounts are strong at 103. These two metrics help gauge the health of a fund.

MR. LUNA directed the Board's attention to the graphic of the four counterparties, State Street, Prudential, PacLife, and Royal Bank of Canada (RBC). There is a plan to add a fifth wrap provider to the portfolios as this availability and capacity increases in the market. MR. LUNA reviewed the sector allocation of the underlying bond portfolios and discussed yield comparisons.

CHAIR SCHUBERT recessed the meeting from 11:45 a.m. to 1:30 p.m.

10. A. Real Assets FY16 Annual Plan
Real Estate Guidelines Policies and Procedures

State Investment Officer STEVE SIKES presented the Real Assets Fiscal Year 2016 Investment Plan. His presentation focused on real estate, farmland, timberland, and infrastructure. The TIPS component of the portfolio is managed by the fixed income team and will be updated at a future meeting. The energy component to the portfolio is managed by the private equity team and also will be updated at a future meeting. The energy investments shown today are only specific subcomponents of the larger energy portfolio.

MR. SIKES stated the real assets comprised 17.4% of total asset allocation, as of June 30th, 2015. The real assets portfolio has three primary goals; to generate attractive returns, to provide diversification, and to provide inflation hedging to the overall portfolio. The strategy is a lower risk, lower return approach that uses conservative leverage and focuses on high quality assets to produce stable returns. The return expectation for real estate, farmland, timberland, and infrastructure is to exceed a 5% net real return over rolling five-year periods. Custom benchmarks are used to evaluate shorter-term performance compared to the market.

MR. SIKES stated the target allocation for real assets for the current fiscal year is 17%, with a band of 8%. The portfolio is within this target at 17.4%, as of June 30, 2015. MR. SIKES showed a graphic illustrating the target levels established for each asset class within real assets compared to the actual sector allocation. Real estate is slightly over the target levels, while farmland and timberland are underweight target levels.

The real assets portfolio returned 3.7% for FY ending June 30, 2015. The weaker energy markets affected this return. Longer term, the portfolio has done well, with almost 9% for the last three years, and over 10% for the last five years. Townsend will provide a detailed presentation on the real estate performance. The REIT portfolio is internally managed and continues to meet its objectives of producing index-like returns. Farmland returned 5.4% last year, which is slightly below the target of 5.7%. This is still meeting its 5% net real return goal, given the low inflation level. Farmland has returned 9.75% over three years, and has returned 10.86% over five years. The U.S. net farm income is anticipated to decline and level off, but is to remain healthy relative to longer-term historical perspectives.

VICE-CHAIR TRIVETTE asked if the droughts in Idaho, California, and Texas are expected to have a substantial impact on the farmland investments. MR. SIKES informed this issue is being observed from a fundamental perspective and a regulatory perspective. The managers have done a good job so far ensuring the water rights on properties are strong.

Timberland is one of the newest additions to the real asset portfolio, beginning in 2008. It returned 8.4% last year, and has done well in both three and five years. There have been few larger opportunities in the market and Hancock has struggled to invest the allocation, with approximately $187 million remaining. They have kept to their investment discipline.

The newest addition to the real assets portfolio is the infrastructure and energy portfolios approved by the Board in FY 14, returning -5.5% for last fiscal year. The benchmark returned -5.1%. All mandates are now fully funded. A big part of the negative performance in the infrastructure portfolio is tied to unhedged currency exposures. The capital markets continue to be healthy across real estate, timberland, and farmland.

MR. SIKES stated the investment recommendations for FY 16 are to stay the course. There are no new strategies recommended at this time. The CIO has the liquid investments in MLPs, REITs, TIPS, and public infrastructure to rebalance the portfolio as determined necessary. MR. SIKES recommends an increase in the allocation to Sentinel Real Estate Advisors by $10 million to address capital expenditure and improvement needs. MR. SIKES recognized the target underweights in farmland and timberland, and informed the CIO has discretion to make additional commitments to existing managers. There is a possible attractive opportunity to make an additional incremental investment to an existing infrastructure manager. The CIO currently has discretionary authority for this possibility.

VICE-CHAIR TRIVETTE reminded the Board the relationship with Sentinel spans over 20 years.

COMMISSIONER FISHER asked if consideration has been given to passive investments in farmland and timberland. MR. SIKES informed there are timber REITs and he would have to research in order to provide a specific answer. MR. SIKES believes farmland would be more challenging because the REITs in that area have struggled.

DR. JERROLD MITCHELL asked if other sectors have been reviewed to add to the portfolio, including hard commodities or intellectual property. MR. SIKES reported no other sectors are currently attractive.

MR. BRICE requested more information about the investments over the past two or three years into the timberland and farmland portfolios. MR. SIKES reported the Board hired two managers in the farmland portfolio. The UBS AgriVest is essentially fully invested. The Hancock portfolio still has capital to invest and has a more challenging time finding opportunities. The Board hired two managers in the timberland portfolio. The TIR is essentially fully invested. The trend for the Hancock portfolio strategy has slowed in finding larger wood product companies who are selling their timberland holdings.

CHAIR SCHUBERT asked if there are crop or timber insurance programs that may cover some of these investments. MR. SIKES noted he will have to respond to that question at a later time. MR. BADER stated managers do not suggest fire insurance for timberland. The farmland managers may require crop insurance if the grower is at risk of not making payments, but the funds do not insure specifically.

MS. ERCHINGER asked if the $122 million remaining to be allocated is reflected in the total portfolio numbers. MR. SIKES stated the 17.4% allocation of real assets does not include uninvested funds. The projected allocations of the next five years make the assumption the capital is getting invested. MR. SIKES explained the dynamic part of the CIO's management of additional allocation. Historically, funds have come from fixed income when a capital allocation occurs.

MR. PIHL commented on the huge shift in the timber industry over the last 10 to 15 years to the production of OSB or wafer wood rather than plywood.

B. Consultant Evaluation of Real Estate Plan: Diversification, Compliance, & Performance Measurement

MICOLYN MAGEE, Townsend Group, provided a presentation regarding the previous year's evaluation of compliance to the program, performance relative to peers and objectives, and review of the appropriateness of any actions taken by staff. MS. MAGEE introduced her colleague CHRIS CUNNINGHAM, who works on the day-to-day production of reports on this account and is another resource person for the Board and staff.

MS. MAGEE reminded the Board about the idea to slowly fund the other real asset classes out of real estate through liquidations and the public securities portfolio. She believes this activity is going well and is within the expected timing and duration. The real rate of return objective is 5%, and performance has been strong since 2013. MS. MAGEE informed the public portfolio performance has been low and/or negative in the last year and quarter, but is performing very close to the index. MS. MAGEE indicated the tracking and the performance of the public securities managed by staff appears to be well managed and doing a good job, creating value for the portfolio.

MS. MAGEE discussed the private portfolio. She noted the returns are exceeding all benchmarks and well above the long-term norms. These are extraordinary returns for a real estate portfolio and are expected to moderate. The since inception gross return of 8.2% for the ARMB program is comprised of an 8.5% core return and a 6.5% non-core return. The net return for core is 7.4% and the net return for non-core is 4.7%. The fees for non-core real estate are much higher across the board, because they are paid on commitment fees, regardless of returns. MS. MAGEE reported the portfolio is within compliance for every element of the program structure and policies within the strategic plan.

MS. MAGEE discussed ARMB is a very low leverage core investor with 8% leverage in core, which contributes to the low volatility and stable returns. Non-core is at 44% and is also considered to be a low leverage investor, because the expected limitation is about 65%. MS. MAGEE informed Sentinel and UBS took over the assets of Cornerstone, and a reasonable write-down adjustment in the first quarter is anticipated, showing negative numbers and impacting performance for a short time. If an asset has not been sold by a manager three years after takeover, it is considered a purchase decision and moved into a permanent portfolio position.

MS. MAGEE reported detailed discussions were held with LaSalle regarding the separate account and each of the assets. There are some unique issues with the properties, but no great concerns, and LaSalle is working through the issues. MS. MAGEE reviewed the rolling five-year analysis and informed the core portfolio is trending with the market. She cautioned the use of the non-risk-adjusted separate manager chart, because the underlying assets are unknown. MS. MAGEE advised the core portfolio's managers are doing a good job, given the mandates, the size, and the risks in the portfolio. There are no changes in holdings recommended.

MS. MAGEE reviewed the performance of the non-core portfolio and indicated the investments have been well above the NCREIF Index, exceeding expectations. The longer-term investments dilute the non-core performance number because of vintage year allocations in 2004 through 2007. Some of the allocations in the later years are recovering funds and the allocations in 2014 are doing very well.

MR. BADER requested discussion about using leverage to increase investment returns and an explanation of zombie funds. MS. MAGEE explained leverage increases returns on the upside and increases negative returns on the downside. She believes the use of leverage in Alaska's accounts would be counterintuitive, because of the 5% real rate of return target. MS.

MAGEE noted zombie funds are investments that were negotiated at the peak with great clawbacks and great incentive fees. The investors are now gone and the leverages may have been so significant that the assets were given back and remain unsold due to market conditions.

MS. MAGEE continued the presentation and noted the separate account managers did a great job culling portfolios and getting rid of assets that were no longer accretive to the performance. Staff invested in Almanac VII. Townsend believes this is a successful team. Staff invested in Clarion Development Ventures 4, of which they have an extreme comfort and an extensive understanding. MS. MAGEE does not recommend development today, because of the risk involved.

MS. MAGEE stated staff made the correct decision in pulling funds for capital calls from other resources, instead of pulling from the negative market and realizing losses. The recommendations for next year are consistent with last year's recommendations to stay the course, maintain the portfolio, work to improve returns, and allocate to new comingled funds, as appropriate. Townsend will continue to provide staff with pipelines, best ideas, and to keep informed of the market cycles.

C. Adoption: Real Assets FY16 Plan & Policies Board Discussion

Action: Real Assets FY16 Annual Plan
Resolution 2015-15

MR. SIKES advised all the action memos are included in the packet. Resolution 2015-15 details the recommendation page for the annual plan.

MS. RYAN moved to adopt Resolution 2015-15. MRS. HARBO seconded the motion.

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

Action: Revised Investment Guidelines
Resolution 2015-16 - Real Estate

MR. SIKES stated Resolution 2015-16 relates to revisions of the investment guidelines, including the removal of the reference of the Real Assets Committee because the Board dissolved the Real Assets Committee earlier this year.

VICE-CHAIR TRIVETTE moved to adopt Resolution 2015-16. MRS. HARBO seconded the motion.

VICE-CHAIR TRIVETTE reminded the Board the decision to abolish the Real Assets Committee was supported by all members and staff.

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

Action: Revised Investment Guidelines
Resolution 2015-17 - Farmland

MRS. HARBO moved to adopt Resolution 2015-17. MS. RYAN seconded the motion.

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

Action: Revised Investment Guidelines
Resolution 2015-18 - Timberland

MRS. HARBO moved to adopt Resolution 2015-18. MS. RYAN seconded the motion.

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

Action: Revised Investment Guidelines
Resolution 2015-19 - Infrastructure

MRS. HARBO moved to adopt Resolution 2015-19. MS. RYAN seconded the motion.

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

CHAIR SCHUBERT recessed the meeting from 2:42 p.m. to 2:57 p.m.

11. EXECUTIVE SESSION

MR. BRICE moved to go into executive session to discuss two confidential matters: consideration of a small cap investment strategy and consideration of a higher and better use of a real asset, the immediate knowledge of which would clearly have an adverse impact upon the finances of the ARM Board. Public disclosure of these matters could affect the value of current investments and could impair the ability of the Board to acquire, maintain, or dispose of assets. COMMISSIONER HOFFBECK seconded the motion.

A vote was taken, and the motion passed unanimously.

RECESS FOR THE DAY

CHAIR SCHUBERT directed the recording device be turned off and the phone be disconnected. The meeting was recessed at 2:58 p.m.

Friday, September 25, 2015

CALL BACK TO ORDER

CHAIR SCHUBERT reconvened the meeting at 9:00 a.m.

Trustees Trivette, Hoffbeck, Fisher, Harbo, Erchinger, Brice, Ryan, and Pihl were also present.

12. PERFORMANCE MEASUREMENT - 2nd Quarter

MR. ERLENDSON and STEVE CENTER of Callan Associates, Inc., provided a detailed report on the second quarter performance measurement, through June 30th, 2015. MR. ERLENDSON requested Board members ask questions and make suggestions about additional information to include in future Board reports. Staff receives a much larger set of exhibits than what is included for the Board. MR. ERLENDSON noted the presentation provides context to the market overview and uses the PERS fund as a proxy for the pension assets.

MR. CENTER reported on the U.S. economy through the end of Q2. The final GDP number rebounded to 3.7% from 0.6%. It had been pushed down by a combination of weather, energy prices, and a strong dollar impacting exports. Improvements in the labor markets continued, with the unemployment rate down to 5.3%. Payroll has seen an uptick in growth. Inflation has been muted, mainly due to the drop in energy prices. In Q2, the S&P 500 return was 0.3%, the U.S. mid cap S&P 400 was -1.1%, and the Barclays Aggregate Index was -1.7%.

MR. ERLENDSON commented markets were doing fairly well through June 30th, and since then, markets have reversed. Interest rates have nudged up and are expected to rise before the end of the year. The dollar has strengthened, which has impacted performance returns for U.S. investors investing outside the United States. MR. ERLENDSON showed the year-to-date returns from January 1 through September 24, the S&P 500 at -4.7%, the mid cap S&P 400 at -3.2%, the Russell 2000 at -4.7%, the EAFE Index at -5.7%, emerging markets at almost -16%, and the fixed income market Aggregate Index up 1%.

MR. ERLENDSON reported the growth strategies have outperformed the value strategies over the last year. Sector dispersion was large with healthcare coming in strong for the quarter and utilities having difficulty in performance. The drop in energy prices had a substantial impact on the earnings per share growth in the S&P 500 at -5.6%. Internationally, Japan showed some strength during the quarter, even though the yen was down slightly. The euro rose versus the dollar during the second quarter. On a sector basis, telecom and energy performed quite well internationally. I.T. and emerging market I.T. was a big drag on performance of non-U.S. equities. Over the last year, investors within the MSCI EAFE Index would have returned almost 12%. U.S. dollar investors returned -4.2%, almost a 16% swing, which is driven entirely by the strengthening of the U.S. dollar relative to non-U.S. currencies. Over the last 10 years, the U.S. dollar has depreciated against most non-U.S. currencies and these variances are expected to smooth out over time.

The fixed income yield curve showed a slight uptick during the second quarter, but has since flattened out again during the third quarter-to-date. The Barclays Aggregate gave back much of the gains it had earned during the first quarter. MR. ERLENDSON discussed credit has been a difficult area within fixed income because of the high correlation to equities. The non-credit type fixed income sectors have been able to general positive returns. The percentage allocated to fixed income within public funds has steadily declined over the last 20 years. The fixed income allocations have been reallocated by many investors into either equity-oriented strategies or real asset type strategies.

The NCREIF Property Index returned 3.14% last quarter. The REITs had a difficult quarter at -9.95%. The global REIT space was down -6.5%. MR. BADER requested Callan's explanation on the consideration of REITs as real estate. MR. ERLENDSON informed Callan believes REITs are equity securities that are sector specific and highly correlated to the equity market. The factors that drive the REIT performance include a significant element of real estate type activity. REITs, as an asset, are viewed as a sector of the publically traded equity market. REITs have flexibility in the way they are utilized in smaller portfolios as real estate exposure. It is not recommended that large and sophisticated clients utilize REITs to fill the real estate allocation.

MR. ERLENDSON reviewed the actual asset allocation for PERS versus the target asset allocation and all fall within about a 1% band. This reveals very tight control and a disciplined active procedure to maintain the stated risk tolerance of the funds. Discussion continued regarding the utility of the chart showing PERS allocation versus other public pension funds. Real assets and global exposures are much higher than the typical fund, and fixed income allocation is much lower than the typical fund. This allocation is based on time horizon and risk tolerance.

Performance attributes were shown for the quarter and one year, outlining the manager effect in the portfolio versus the benchmark. Collectively, the manager effect has been positive and has added approximately 50 basis points of value before fees over the benchmark for both the quarter and the trailing one-year period.

COMMISSIONER FISHER requested the net of fee performance numbers be included, in addition to gross of fee performance, as part of the relative attribution effects chart in future presentations. He believes it is important for the Board to have net of fee performance correlation against the benchmarks. MR. ERLENDSON indicated the larger staff report contains tables showing the net of fee returns for each manager. The request will be included in the next report. Most comparisons are shown gross of fee because of the differentiating fee structure for peers.

MR. ERLENDSON discussed the cumulative long-term performance as of June 30, 2015. The total fund returns continue to closely track the strategic allocation target. Since the volatile 2008/2009 period, total fund performance has closed the gap versus the actuarial return. MR. ERLENDSON explained the portfolio is trending to achieve the actuarial target rate of return over the long-run. MR. PIHL commented the six-year, and never seven-year run of the market, is apt to change these results, which calls into question the interest assumption. MR. ERLENDSON agreed markets trend.

MR. ERLENDSON noted the returns over the last six years for the domestic equity portfolio compared to the Russell 3000 Index are slightly below benchmark. He views this as a successful implementation, given the alternative equity pool which dampens volatility and lowers the return expectation. The small cap pool includes both small cap and microcap. Performance has been ahead of benchmark over the last three years and median over the shorter-term. Microcap-oriented portfolios have not been performing well, and the small cap portfolio has a smaller bias built into it compared to the index.

DR. JERROLD MITCHELL requested discussion regarding investment opportunity in the universe of small cap managers. MR. ERLENDSON explained the returns reflect the small cap managers are capacity-constrained. One of the challenges for large institutions is to get meaningful commitment to the small cap asset class without locking up all of the capacity of a given manager. The range of returns within the small cap universe is typically wider than it is for the large cap universe, because small differences in portfolios can result in very big differences in returns. It is a positive outcome the portfolio's results have remained close to the average. The new microcap investment Zebra has been performing particularly well relative to their benchmark.

MR. ERLENDSON indicated the microcap value manager DePrince, Race & Zollo has disappointing results, but is accurately reflecting the lower returns, given that small cap value is the lowest returning of all equity styles and capitalization. International equity is ahead of benchmark and better than average over the long-term. The international portfolio consists of developed market and emerging market strategies. The developed market portfolio is ahead of benchmark over all cumulative periods. The emerging market pool has been more challenged, and the returns are at the low end of the distribution over cumulative periods. During the second quarter, returns have risen. Callan and staff are closely observing this area to determine if changes are necessary.

MR. ERLENDSON commented the bond portfolio is very high quality. He is supportive of diversifying the high yield managers going forward. Two candidates, out of a universe of 300 candidates, have risen to the top for recommendation later in the meeting. The absolute return portfolio is at the top of the distribution for all periods, except the most recent quarter.

MR. CENTER reviewed the stoplight pages, noting the Balanced Funds and Target Date Funds are mostly beating their benchmark and peer group. The socially responsible strategies have had a difficult period of performance versus the rest of the equity market. There is no current concern with this performance lapse from RCM. It remains a very solid selection over the long-term and will be followed. The passive options have performed in line with expectations. The rankings for the money market funds are essentially meaningless because each rank is within five basis points. The money market fund benchmark over the last five years is 0.1%, and there is no concern with performance. The overall allocations of the portfolio are performing very well.

DR. JERROLD MITCHELL made an observation regarding the domestic equity chart on slide 24. The one-year returns show a much greater dispersion than the 10-year returns. The grouping will be tighter over the long-term and farther apart over the short-term. He indicated the manager lineup has also changed significantly over the time period.

13. HIGH YIELD MANAGER SEARCH

A. Eaton Vance

MR. BADER reported the Board authorized staff and Callan to conduct a search for additional high yield managers. He described the thorough, highly professional screening and final selection process of two managers to recommend to the Board. MR. BADER introduced RODRIGO SOTO, Institutional Business Development, MICHAEL WEILHEIMER, Portfolio Manager, and STEPHEN CONCANNON, Portfolio Manager, of Eaton Vance Investment Managers.

MR. SOTO expressed appreciation for being in front of the Board today, and provided an overview of the Boston-based investment management firm, established in 1924. The firm has over $300 billion in assets under management, of which approximately $100 billion is diversified across the fixed income spectrum. Eaton Vance has a long-term, time-tested, and consistent investment philosophy. MR. WEILHEIMER has been with the firm for 25 years, and MR. CONCANNO has been with the firm for 15 years. The broader resources, including global affiliates, available to the high yield team consist of 170 investment professionals.

MR. CONCANNON reviewed the biographies of the high yield investment team managers shown on slide eight. He described the analysts' responsibilities and noted sector allocations are delegated for the long-term. History covering a particular sector is a competitive advantage, because it allows for building a better mosaic of information through market cycles, which leads to better investment decisions. There are two dedicated traders on the team, who understand credit and are looking to add value to the portfolios.

MR. CONCANNON explained the investment market is 85% in U.S. companies and 15% in non-U.S. The non-U.S. is comprised half in Western Europe. There is currently one senior global analyst based in London, and two additional research analysts are expected to be added. MR. CONCANNON advised the portfolio capitalizes on structural and behavioral inefficiencies in the high yield market through in-depth fundamental credit analysis. The characteristics are core high yield investors, with a focus on the single B part of the market. Historically, returns have been competitive, and the risk metrics is top quartile in every timeframe referenced.

MR. CONCANNON provided a detailed review of the investment process and portfolio construction, including fundamental qualitative and quantitative assessment of the business, covenant structural analysis, and fundamental credit research. The analysis is thoughtful of down market capture, focusing on capital structure, adequacy of capital cushion, free cash flow characteristics, and a conservative position with cyclicals. Portfolio construction is 90% bottom-up, and 10% market factor analysis. The preference is for transparent and cash generative businesses with a shorter duration perspective compared to the benchmark. These tend to hold value better in periods of market turbulence.

MR. BRICE asked if the portfolio has a geographical regional bias. MR. WEILHEIMER stated the preference is U.S. based companies, because the bankruptcy codes are enforced and the corporate governance is more transparent.

MR. ERLENDSON inquired as to the best benchmark to evaluate whether or not the portfolio's investment process was successfully implemented, given the aspects of fixed income and correlation to the equity market. MR. WEILHEIMER explained this is a hybrid asset class with dual correlations. He believes the portfolio's ability to outperform peer groups in down markets, while capturing upside returns, indicates their strategy is successful.

MR. CONCANNON indicated risk is managed throughout the portfolio construction process, by focusing on the company's cap structure, managing duration, sector weightings, ratings, quality, and utilizing Barclays POINT system to monitor historical risk through attribution and analyze prospective risk. The portfolio is expected to be comprised of 250 to 300 companies, with the top 10 positions representing 15% to 25% of portfolio assets. The overweight sectors include healthcare, retail, and services. Underweight sectors are banks and thrifts.

DR. JENNINGS asked if bond market liquidity is a challenge or an opportunity for this strategy. MR. WEILHEIMER believes bond market liquidity is an opportunity for institutional mandates, potentially at the expense of mutual funds. The industry has not responded yet to the recent rule changes by SEC regarding definitions of liquidity. One of the strategies clients may allow is to hold cash, instead of being fully invested at all times, in order to capture the opportunities when the market comes off. Derivatives are not used in the strategy. Clients may have discussions regarding being long CDX, which is essentially a derivative of the index. The CDX market is the most liquid security to hold. Returns can be enhanced by having liquidity or cash when the market trades down.

CHAIR SCHUBERT recessed the meeting from 10:32 a.m. to 10:42 a.m.

B. Columbia Threadneedle Investments

GREG SPRADLING, Business Development Institutional Distribution, and JENNIFER PONCE DE LEON, Senior Portfolio Manager, of Columbia Threadneedle, expressed appreciation for being in front of the Board today, and gave a detailed presentation regarding the high yield fixed income strategy. MS. PONCE DE LEON has been with the firm since 1997, and is the Head of High Yield Fixed Income. The team manages approximately $16 billion of client assets, for about 40 institutional clients. The quality strategy of the portfolio produces consistent investment returns, while focusing on downside risk management.

MS. PONCE DE LEON informed Columbia Threadneedle is a wholly owned subsidiary of well-resourced Ameriprise, who manages $505 billion in assets, and provides financial advisory, insurance, and annuity services. Columbia Threadneedle includes a London-based operation, which utilizes the global resources of the company, as markets become increasingly global. MS. PONCE DE LEON described the company's commitment to research resources with 82 analysts and 78 portfolio managers. Specifically for the high yield assets, there are 21 experienced individuals across portfolio management, research, and trading. The portfolio management team has been together for 17 years, creating a quality partnership environment that drives performance.

MS. PONCE DE LEON explained 2/3 of the alpha of the portfolio is expected to be generated through credit selection. The approach is a risk-adjusted process managing the downside risk. The next 1/3 alpha is expected to be generated through the credit cycle through tactical portfolio management, positioning for the environment ahead. The three tactical adjustments in positioning include quality of the portfolio, capital structure positioning, and industry positioning. This is a combination of bottom-up security selection and top-down positioning, while reducing volatility through downside principal preservation. This process has generated 208 basis points in excess return since inception, with 84% of the volatility of the market. The upside and downside capture ratios relative to the market are strong and very compelling.

MR. BRICE asked if the assets will be focused in a particular geographical region. MS. PONCE DE LEON explained the benchmark incorporates about 15% foreign companies, but they are all U.S. dollar denominated.

MS. PONCE DE LEON explained the portfolio will include 150 to 200 different issuers and the ability to manage and evaluate more credits allows for the diversification that pays dividends to clients. The overall position will run within a 3% working maximum on any individual issuer based on capitalization, with no more than 10% to 20% of an individual issue, in terms of ownership across the company. An unfavorable industry may have a zero weighting and a favorable industry may have an overweight of up to 150% of the benchmark.

Columbia Threadneedle has used its own system of research since 1998, which evaluates companies from a forward-looking risk basis to ensure there are positive catalysts to drive the security. The research also reviews the companies on relative value from a security performance basis. The portfolio is not buy and hold. It is actively managed for downside risk and capital preservation. The analysts have a workload that allows them to cover their industries well and are limited to two to four different industries, with roughly 50 names within the opportunity set. This allows for well-resourced analysis of the recommendations. The rating system assists in managing the overall risk in the portfolio, as well as risk at the issuer level.

MR. BRICE asked if this portfolio favors particular sectors. MS. PONCE DE LEON believes the heavy asset businesses are favored. She indicated there is a place for any industry credit with high returning potential. MR. BRICE asked in what economic scenario does this strategy work best. MS. PONCE DE LEON stated the degree of all performance is going to be greatest in down markets. The second level would be in a regular, low growth environment. The portfolio in a high growth, beta-oriented environment would capture the majority of the performance, but would probably underperform.

MR. ERLENDSON asked for more information regarding the structure of the portfolio during its good performance in the down market in '08 and up market in '09. MS. PONCE DE LEON explained the team will stay true to the security selection discipline, while having the courage and insight to act on the evaluation of the market environment. The experience of understanding volatility and becoming more defensive than cyclical, along with the diligence in the company modeling information, provides the confidence needed to take advantage of opportunities during both markets environments. The tactical approach is an intentional strategy, combining superior credit selection with downside risk management. This allows for a consistent, repeatable process of managing high yield to get strong risk-adjusted returns with less volatility.

VICE-CHAIR TRIVETTE asked about the pressures senior positions in the company place on this strategy during market volatility. MS. PONCE DE LEON indicated the management look to her for guidance and trust the track record. She believes it is a supportive partnership.

14. INVESTMENT ACTIONS

A. High Yield Manager Approval

DEPUTY CIO BOB MITCHELL stated staff asks for authorization to hire both Eaton Vance and Columbia Threadneedle for the high yield investment mandate, subject to successful contract and fee negotiations.

<u>MRS. HARBO moved to authorize staff to hire both Eaton Vance and Columbia Threadneedle for the high yield investment mandate, subject to successful contract and fee negotiations. MS. RYAN seconded the motion.</u>

MR. BRICE requested the amount of each allocation. MR. BADER informed the MacKay Shield allocation would be reduced by $400 million, and $200 million would be given to each manager.

CHAIR SCHUBERT asked if staff believes these managers offer an advantage over index funds, after factoring fees. MR. MITCHELL replied that both managers' net performance is greater than the index, and are able to outperform during the downside, providing a valuable attribute to the overall portfolio.

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

B. High Yield Investment Guidelines
Resolution 2015-20

DEPUTY CIO BOB MITCHELL stated the Board authorized the investment in a Fidelity Real Estate High Income Pool in June. The investment guidelines, when originally written, did not contemplate an investment of this nature and require revision in order for the manager to be compliant. The proposed change is an addition of a sentence allowing for the investment in this strategy. The prospectus for the strategy would apply and the existing high yield investment guidelines would apply for other high yield managers in this space.

MRS. HARBO moved to adopt Resolution 2015-20. MS. RYAN seconded the motion.

A vote was taken, and the motion passed unanimously.

C. Securities Lending Program

DEPUTY CIO BOB MITCHELL reported staff recommends the Board restart securities lending for the portfolio and modify the securities lending program to include cash collateral, which staff would internally manage, in addition to the borrower default indemnification. Staff requests the approval authority over investment guidelines of any externally managed cash collateral pools. Staff recommends a negotiated split between State Street and the ARM Board. Staff recommends the ability to exclude specific securities or portfolios from the securities lending program, respecting investment manager concerns. Staff recommends a securities lending strategy that relies on implicit yield, essentially lending out only the special securities in the portfolio, rather than making the entire portfolio available.

VICE-CHAIR TRIVETTE moved to restart a securities lending program to include internally-managed cash collateral, staff approval authority over investment guidelines of externally managed cash collateral pools, a negotiated split between State Street and the ARM Board, the ability to exclude specific securities or portfolio, and a strategy that relies on implicit yield. COMMISSIONER HOFFBECK seconded the motion.

MS. ERCHINGER requested the advantages of using State Street. She asked if staff intends to bring the contract before the Board for approval. MR. MITCHELL advised staff considered the operational complexity that would be introduced by a third-party management firm. Staff is comfortable employing the current custodian State Street. MR. MITCHELL noted staff is happy to bring a specific policy back in front of the Board for review, prior to initiating the securities lending program.

COMMISSIONER FISHER expressed his concern about the securities that are the most valuable to lend are also the most illiquid and present the most risk, in terms of returning them to the managers. He encouraged manager communication and coordination regarding specific lending. MR. BADER agreed and stated the returns of the managers are far more important than the possible incremental gain from securities lending.

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

D. Small Cap Strategy

DEPUTY CIO BOB MITCHELL advised staff recommends the ARM Board authorize the creation of a fund for the purpose of investing in small capitalization domestic equity ETFs, and invest up to $200 million in the strategy. The fund would be benchmarked against the Russell 2000 Index.

MRS. HARBO moved to authorize the creation of a fund for the purpose of investing in small capitalization domestic equity ETFs, and invest up to $200 million in the strategy. MR. BRICE seconded the motion.

MS. HARBO asked if this fund would be managed in-house. MR. BOB MITCHELL agreed. MS. HARBO asked for the amount of assets currently being managed in-house. MR. BADER stated there are approximately $200 million in REITs, $200 million in equity yield, and adding this strategy of $200 million, would bring the total to about $600 million. There is an intent to increase the allocation in the equity yield strategy. Staff's goal is to have $1 billion under internal management in the equity space before the end of the year, with the Board's concurrence.

VICE-CHAIR TRIVETTE asked if staff believes this is a manageable, considering the additional staff members expected to come onboard. MR. BADER stated he fully anticipates this is manageable with existing staff, and hopes to expand the program beyond the current vision with additional staff coming in.

CHAIR SCHUBERT expressed her support of the investment staff and this action. She believes allowing the investment staff to expand presents interesting challenges and opportunities, and helps against poaching from other companies.

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

E. Low Volatility Strategy

DEPUTY CIO BOB MITCHELL presented the information included in the Board's packet entitled Minimum Variance Portfolio Internal Management. This type of portfolio is comprised of securities and weights that are expected to minimize the portfolio's volatility. They are selected using a factor-based approach that attempts to measure the correlations and co-variances of the performances of the underlying securities to develop a portfolio that will have lower volatility. There is currently an existing similar strategy started last December with SSGA as the portfolio manager. Access to the index positions will be acquired by a Switzerland company STOXX.

MR. MITCHELL advised staff recommends the Board authorize up to $200 million investment in an internally managed domestic large cap minimum variance portfolio, benchmarked again the STOXX USA 990 Minimum Variance Unconstrained Index.

MR. BRICE moved to authorize staff to manage a $200 million investment in an internally managed domestic large cap minimum variance portfolio, benchmarked against the STOXX USA 900 Minimum Variance Unconstrained Index, and the authorization is subject to successful license, fee, and contract negotiations with STOXX Limited. MRS. HARBO seconded the motion.

COMMISSIONER FISHER requested DR. JENNINGS' opinion. DR. JENNINGS commented there are multiple factors in the stock market and there is growing academic evidence this minimum variance strategy is being included as a factor to explain performance. He believes the chart shown in the presentation captures the strategy as providing higher returns and smoothing out the risk/reward tradeoff.

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

UNFINISHED BUSINESS

1. Disclosure Report
2. Calendar

MS. HALL indicated the Disclosure Report and calendar were included in the Board's packet. There are no updates and nothing unusual to report.

3. Legal Report

MR. GOERING informed he will be meeting with MR. BADER to discuss the Guggenheim SEC consent decree issue. MR. GOERING provided written advice regarding the Actuarial Committee Charter, and has been engaged and will continue to be available for follow-up discussions regarding that advice.

NEW BUSINESS

VICE-CHAIR TRIVETTE requested the DC Committee meeting in April and September be tentatively added to the calendar.

OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD

MS. ERCHINGER suggested the Board send a letter to the Legislature regarding the FY 17 contribution rates approved this meeting, and specifically acknowledge the rates were approved based on investment return smoothing. She suggested the Legislature be provided with both sets of actuarial result information, smoothing and non-smoothing, and explain the Board's decision.

VICE-CHAIR TRIVETTE agreed with the recommendation and suggested including the explanation from the actuaries that part of the definition of smoothing is removing the corridor, and that was completed. VICE-CHAIR TRIVETTE believes providing the information to the Legislature may make the Board's decision-making clearer.

COMMISSIONER HOFFBECK concurs with the recommendation. He believes the discussion on the budget will be critical this year and it is important for the Legislature to understand what the Administration is presenting is in line with this Board. Providing the additional information for the Legislature to analyze will be helpful.

CHAIR SCHUBERT commented the Board will work together to compose the letter.

PUBLIC/MEMBER COMMENTS

None

INVESTMENT ADVISORY COUNCIL COMMENTS

None

TRUSTEE COMMENTS

COMMISSIONER HOFFBECK believes it is incumbent upon the Board to inform the Legislature on why it is a good decision to move more and more fund management in-house, in light of the declining state budgets. These positions are approved by the Legislature and the Board's support is needed in moving these programs forward.

MR. BRICE informed issues have been brought to his attention vigorously regarding the retiree program, in terms of coordinating benefits. He was requested to address a particular situation in this public forum of a husband and wife team, both retirees out of the State system, and the retiree health system is having a hard time coordinating benefits.

COMMISSIONER FISHER commented he is aware of similar issues, and appreciates hearing about individual issues to address specifically. A Retiree Advisory Committee is being established to advise on healthcare issues. More information will be presented at the December meeting.

MRS. HARBO expressed her appreciation to MS. ERCHINGER for her work on the Actuarial Committee. She expressed her appreciation to MS. HALL for her preparation and good work.

VICE-CHAIR TRIVETTE expressed his appreciation to MR. BADER for his work and research in bringing important strategies to the Board. VICE-CHAIR TRIVETTE noted he has also heard concerns regarding the issues with the retiree program. He believes the Administration and staff has made progress, spent considerable time addressing issues, and more time is needed. VICE-CHAIR TRIVETTE expressed his appreciation to staff and DRB for the cooperation given to the Defined Contribution Committee.

FUTURE AGENDA ITEMS

None

ADJOURNMENT

There being no objection and no further business to come before the Board, the meeting was adjourned at 11:48 a.m. on September 25, 2015, on a motion made by MRS. HARBO and seconded by MR. BRICE.

Chair of the Board of Trustees
Alaska Retirement Management Board
ATTEST:

Corporate Secretary

Gayle Harbo