



ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson
Director*

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

Friday, March 27, 2015

8:30 A.M., MST

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Kevin McCarthy, Chair of the ASRS Board, called the meeting to order at 8:32 A.M., Arizona Time.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Kevin McCarthy, Chair
Mr. Jeff Tyne
Dr. Richard Jacob
Mr. Tom Manos
Mr. Tom Connelly
Professor Dennis Hoffman

A quorum was present for the purpose of conducting business.

2. Presentation Regarding PRIDE Award for Professionalism

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, recognized the following nominees for the PRIDE Award for Professionalism: Russ Levine, Benjamin Robinson, Mark Muraoka, Randi Gray, Patrick Toto, Carrie Waith and John Davis. They were nominated by staff who feel they exemplify the following PRIDE qualities of professionalism:

- Displays a positive demeanor (friendly, responsive, courteous) even when confronted by adversity
- Has subject matter expertise
- Possesses good communication and active listening skills
- Is a trusted contributor (manager, leader, SME, analyst, teammate)
- Takes personal accountability
- Has a proactive and responsive approach to internal and external customer needs
- Has critical thinking skills
- Has an honest, fair and non-judgmental mindset
- Is adaptable to change that benefits members, associates and stakeholders
- Adheres to the ASRS Code of Conduct

Mr. Guarino presented the PRIDE Award for Professionalism to the award winner, John Davis.

3. Approval of the Minutes of the February 27, 2015 Public Meeting and Executive Sessions of the ASRS Board

Motion: Dr. Richard Jacob moved to approve the Minutes of the February 27, 2015 Public Meeting

and Executive Session of the ASRS Board. Prof. Dennis Hoffman seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 0 excused, and 3 vacancies, the motion was approved.

4. Presentation, Discussion, and Appropriate Action Regarding 2015 ASRS Legislative Initiatives and Legislative Update

Mr. Patrick Klein, Assistant Director External Affairs and Mr. Nicholas Ponder, Government Relations Officer, addressed the Board regarding the 2015 Legislative Session and the ASRS Legislative initiatives. Mr. Ponder presented the Bill Tracker, which summarizes ASRS 2015 legislative initiatives as well as other bills affecting the ASRS.

The following bills were discussed:

- HB2338, ASRS; Disability Program – to remove “total” as it precedes “disability” to reduce confusion to members who may think they must be totally disabled to qualify for disability benefits. This bill was passed after the third read in the Senate on March 25, 2015 and is in the Governor’s Office awaiting the Governor’s signature.
- HB2339, ASRS; Rules – remove “provided in rules” in A.R.S. § 38-703 due to this being related to something that the Social Security Administration has jurisdiction over, not the ASRS. Strike “subject to rules prescribed by the Board” in A.R.S. § 38-755. This bill was passed after the third read in the Senate on March 25, 2015, and is in the Governor’s Office awaiting the Governor’s signature.
- HB2340 – ASRS; LTD Program; Liability – protects the ASRS and/or the LTD Program from bad faith claims and requests the ASRS have the same protection from liability as ERISA plans. This bill was not heard by the February 20, 2015 deadline. Mr. Ponder will continue to work with staff after the legislative session to modify the language so it can be heard in the 2016 Legislative Session.
- SB1095, Community Colleges; Optional Retirement Plans – to specify the ASRS transfer member accounts of NON-RETIRED members only. The ASRS currently does not have a method for transferring the account of a retired member. This bill was passed in the House after the third read and was signed by the Governor on March 23, 2015.
- SB1096 – ASRS; Actuarial Valuation Method – to allow the ASRS to change its actuarial evaluation methods from Projected Unit Credit to Entry Age Normal or some other method as determined by the Board. This bill passed in the House with a technical amendment; therefore, it had to go back to the Senate for a third read where it was passed on March 24, 2015, and is in the Governor’s Office awaiting the Governor’s signature.
- SB1097 – ASRS; Health Insurance Benefits - ASRS 2015 Legislative Initiatives – a conforming legislation bill. This bill passed after the third read in the House and was signed by the Governor on March 23, 2015.
- SB1119 – ASRS; Purchase of Credited Service - approved at the January 30, 2015 Board Meeting – to modify language with respect to the service purchase statutes A.R.S. §§ 38-743, 38-744 and 38-745 as a result of the *Pendergast Case*. This bill passed after the third read in the House and was signed by the Governor on March 23, 2015.

The following are bills that affect the ASRS but not initiated by the ASRS:

- HB2351, sponsored by Rep. Fann, would change the definition of a member of PSPRS as it relates to fire chiefs based on whether they are regularly assigned to hazardous duty, as determined by that individual’s local board. The Legislature, PSPRS and the fire districts that were pushing this bill decided not to pursue this legislation this session and will likely present this in the next legislative session; however, the 2016 proposal will not impact the ASRS.
- HB2446, the purpose of this bill would be to allow the Arizona Board of Regents to study the benefits of developing independent retirement, health care and risk management programs.

This bill was not assigned or heard by the deadline and is dead as a stand-alone bill for this session.

- HB2484, the purpose of this bill is to repeal statutes requiring ASU to distribute income from licensing and patents. Mr. Ponder stated that he was advised to keep an eye on this bill for striker language which could include language to mirror HB 2446 since that bill is dead. There was no movement throughout the legislative session or any striker language.
- SB1121, sponsored by Sen. Lesko, to strike the language “before July 1, 2015” from the statute thereby allowing anyone 65 and older to opt-out as long as they have not had prior ASRS membership and there will be an emergency effective date. This bill passed after the third read in the House and is in the Governor’s Office awaiting the Governor’s signature.
- HB 2320, the purpose of this bill is to allow individuals with a conceal carry weapons permit to bring their weapon into public establishments. This bill does not apply to public buildings with weapons screening devices, educational institutions, facilities operated by the Arizona State Hospital or by a special health district, community college districts, and universities under the jurisdiction of the Arizona Board of Regents. Generally the ASRS would not make any comment regarding such a bill; however, in light of the fact that ASRS owns both the Phoenix and Tucson buildings, Mr. Ponder did make a comment in the Senate Appropriations Committee. It was believed that the Legislature was not aware that the ASRS owns the Phoenix and Tucson buildings; with 31 of the 34 tenants being private tenants; therefore, this information was not contemplated when the bill was drafted. There was no indication that an amendment would be offered to make an exception to the ASRS; therefore, upon the effective date of the bill, should it be signed by the Governor, individuals with a conceal carry weapons permit will be allowed to bring their weapon into the ASRS building. Mr. Ponder has reached out to the Governor’s office to voice the ASRS’ concerns regarding this bill. It is unknown at this time whether the Governor will sign the bill; however, Mr. Ponder will continue to follow-up.
- HB2646, Rulemaking – agencies whose director is not appointed by the Governor are exempt from the rulemaking moratorium which applies to the ASRS.

Mr. Klein took a moment to recognize the effort that Mr. Ponder has put forth in this legislative session. Mr. Klein stated that Mr. Ponder has been an articulate, deliberative and an effective representative of the ASRS and represented the ASRS’ best interests. The Board concurred with Mr. Klein’s sentiments.

5. Presentation, Discussion and Appropriate Action Regarding the ASRS Strategic Asset Allocation Policy (SAAP) Schematic

Mr. Gary Dokes, Chief Investment Officer, presented modifications to the Board of the approved ASRS Strategic Asset Allocation Policy (SAAP) Schematic.

Mr. Dokes explained that subsequent to the February 27, 2015, Board meeting it was determined that the individual ranges for the three ‘Opportunistic Investments’ were incorrectly included. As a result, the Director, CIO and General Investment Consultant recommend a modification to the February 27, approved SAAP Schematic that corrects and clarifies the original intent of the ranges for ASRS opportunistic investments as follows:

1. Maintain the aggregate policy target allocation of 0% and range of 0-10%. Rationale: to provide flexibility to evaluate and select opportunistic investments which may be temporarily available and may be relatively more attractive from a risk/return perspective than other investments. Aggregate Opportunistic Investments consists of Debt, Equity, and Inflation-Linked which are defined as investments that are not included in the ASRS Asset Allocation policy and represents investment opportunities that are tactical in nature.
2. Eliminate the policy ranges for each Opportunistic Investment asset class, i.e., the 0-3% policy ranges. Rationale: a) to correct the original intent of the 0-10% range which pertains to the

aggregate opportunistic investments and not establish policy range limits for each subset of opportunistic investments by asset class and b) to clarify a mathematical inconstancy between the aggregate opportunistic policy range limit of 0-10%; and the underlying three asset class policy ranges limited of 0-3%, i.e., $3 \times 3\% = 9\%$.

Motion: Mr. Tom Connelly moved to approve the Asset Allocation Policy Schematic modifications as denoted in Exhibit A (attached) of the presentation as recommended by the Investment Committee, and as recommended to the Investment Committee by the Director, CIO, and NEPC. Prof. Dennis Hoffman seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 0 excused, and 3 vacancies, the motion was approved.

6. Presentation, Discussion, and Appropriate Action Regarding the Director's Report as well as Current Events

Mr. Paul Matson, Director, stated that he was available to answer any questions the Board may have regarding the Director's Report.

Mr. Tom Connelly raised a question regarding the budget summary. Due to a recent article in the Arizona Republic regarding legal fees in a sister state agency, Mr. Connelly asked Mr. Matson if he was able to provide some clarification regarding the focus on the legal fees in this article and if the ASRS also needs to consider changes in this area. Mr. Matson stated that he cannot comment on whether the legal fees of the other state agency are high, however, he says that the ASRS does try to curtail legal fees. First, the ASRS has a tremendous asset with Ms. Jothi Beljan, Assistant Attorney General, who is multifaceted and also has strong access into capabilities within the Attorney General's Office. Also, although the ASRS must also seek external investment council with extremely focused expertise, the ASRS has implemented processes to mitigate those costs. Mr. Matson provided an example of how this is accomplished both through allocating a portion of legal costs to its investment General Partners, and in netting external legal fees when determining external incentive fees payable to its investment General Partners, where possible. Mr. Matson gave specific credit to Mr. Karl Polen, Private Asset Portfolio Manager, for being the driving force behind this process to manage the ASRS' external legal fees.

7. Presentation and Discussion with Respect to Informational Updates from Prior and Upcoming Committee Meetings

a. Operations and Audit Committee (OAC)

Mr. Jeff Tyne announced that the next OAC meeting will be held on May 12, 2015 at 10:30 a.m. in the 14th floor conference room.

b. External Affairs Committee (EAC)

Dr. Richard Jacob announced that the next EAC meeting will be held on April 10, 2015 at 10:30 a.m. in the 14th floor conference room; however, it may not be necessary if the legislative session has concluded.

c. Investment Committee (IC)

Mr. Tom Connelly announced that the next IC meeting will be held on April 20, 2015 at 1:00 p.m. in the 14th floor conference room and will focus on the ASRS Program Update, the independent program oversight report from NEPC, the Investment Policy Statement and there will be an Asset Class presentation on public equities.

8. Board Requests for Agenda Items

No requests were made.

9. Call to the Public

No members of the public requested to speak.

10. The next ASRS Board meeting is scheduled for Friday, April 24, 2015, at 8:30 A.M., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

11. Presentation, Discussion and Appropriate Action Regarding the Review of the Board Governance Model

Mr. Paul Matson proceeded to provide a high-level summary and then indicated he would open it up for discussion, if the Board should have any questions.

The creation of the ASRS Board Governance was based on five elements:

1. Determining the optimal and appropriate allocation of roles of the organization (Board and staff);
2. Determining effective controls;
3. Determining effective communication mechanisms;
4. Determining an efficient organizational structure; and
5. Documentation

The end result was the development of a strategic plan with the following priorities:

1. Sustainability
2. Risk Management
3. Investment Structure and Strategy
4. Customer Service
5. Productivity

Mr. Kevin McCarthy asked Mr. Matson how the ASRS Governance Model compared to others around the country and if, in his opinion, this was a better governance model than some of the others. Mr. Matson responded by citing some of the differences in governance practices around the country, including:

- Although the ASRS does not have control over the determination and appointment of Trustees, the current system requiring both executive nomination and subsequent senatorial approval with staggered terms has worked well. De-politicizing Board appointments and staffing appears to be beneficial for pension funds.
- The delegation of investment decision-making is not common and has resulted in more timely decisions and a more action oriented framework. Mr. Matson indicated that this is unique and not the standard across the United States. Mr. Connelly added that separation of decision-making and oversight was an additional advantage of this level of delegation.

Dr. Richard Jacob asked Mr. Matson if he had any further suggested changes for improvement to what the ASRS already has in place and Mr. Matson responded by saying there were several items that should be periodically discussed but not necessarily on an annual basis. Those items are decision-making with respect to: procurement, staffing and compensation, and budget, each of which the ASRS does not have currently. At the same time, Mr. Matson complimented the approach at the Arizona Department of Administration (ADOA) which has resulted in a positive working-relationship.

The Board took a recess from 9:30 a.m. to 9:49 a.m.in preparation of the final agenda topic.

12. Presentation and Discussion Regarding the Fiduciary Education with the Focus on Integrating Leadership, Stewardship and Governance

Mr. Paul Matson opened the discussion by stating that the Board Governance Policy Handbook mandates the Trustees receive annual fiduciary education. In the past, the education was completed internally by Ms. Jothi Beljan, and this year it will be presented by an external vendor, 3Ethos. Mr. Matson introduced Mr. Don Trone, CEO and 3Ethos Founder, and Ms. Mary Lou Wattman, 3Ethos Co-Founder.

Mr. Trone's and Ms. Wattman's presentation focused on teaching the framework for integrating leadership, stewardship and governance. Some specific topics discussed were as follows:

- Fiduciary Evolution
- Decision-making Hierarchy
- 10 Attributes of Ethotic Leadership
- 10 Stewardship Attributes
- Two Faces of a fiduciary Standard: Positive and Punitive
- Uniform Fiduciary Requirements
- 12 Praxes-Experimental Lessons and Skills to practice daily to make leadership, stewardship and decision-making more authentic and aligned

The Trustees, Mr. Matson and Mr. Guarino participated in a leadership assessment days prior to the meeting, the results of which were briefly discussed in order to:

- Increase self-awareness
- Prompt conversations
- Provide suggestions in approaching others
- Resolve, prevent or minimize conflict
- Understand perspectives of clients or teams
- Find perspectives missing from teams

13. Adjournment of the ASRS Board

Mr. Kevin McCarthy adjourned the March 27, 2015, meeting at 2:03 p.m.

ARIZONA STATE RETIREMENT SYSTEM

Melanie A. Alexander
Board Administrator

Paul Matson
Director