MINUTES
PUBLIC MEETING
ARIZONA STATE RETIREMENT SYSTEM BOARD

Friday, April 28, 2017
8:30 a.m.

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012. Mr. Kevin McCarthy, Member of the ASRS Board, called the meeting to order at 8:31 a.m.

The meeting was teleconferenced to the ASRS office at 4400 E. Broadway, Tucson, Arizona 85711.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Clark Partridge
         Mr. Harry Papp
         Mr. Jim Hillyard
         Mr. Kevin McCarthy
         Mr. Michael Miller
         Mr. Tom Manos

Absent: Mr. Michael Lofton
        Mr. Rene Guillen

One vacant position.

A quorum was present for the purpose of conducting business

2. Presentation, Discussion, and Appropriate Action Regarding Board Elections of Chair or Interim Chair and Vice-chair or Interim Vice-chair.

Mr. Kevin McCarty introduced the topic and turned the presentation over to Mr. Paul Matson, Director, who provided a brief summary regarding the new Trustee membership and the current lack of a Chair and Vice-chair. Given that there was no current Chair to open the nominations, Mr. Matson opened it up for nominations for Chair and Vice-chair through FY 2018.

Motion: Mr. Clark Partridge moved to nominate Mr. Kevin McCarthy as the ASRS Board Chair. Mr. Harry Papp seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

Motion: Mr. Clark Partridge moved to nominate Mr. Tom Manos as the ASRS Board Vice-chair. Mr. Jim Hillyard seconded the motion.
By a vote of 6 in favor, 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

3. Presentation, Discussion, and Appropriate Action Regarding Service Recognition for Prior ASRS Board Trustees

Mr. McCarthy introduced the topic and turned the presentation over to Mr. Matson, who noted this is an unusual meeting topic due to the number of departing and incoming Trustees and the long service of several members. Mr. Matson requested to have this agenda item added to allow staff and Board members who had served with the departing Trustees the opportunity to share comments, if they wish, about the departing Trustees with regard to their time served on the ASRS Board. Mr. Matson asked each of the departing Trustees to stand and introduced them as follows: Mr. Tom Connelly, Professor Dennis Hoffman, Dr. Richard Jacob and Mr. Jeff Tyne.

Mr. Matson began by addressing the operations oversight by Mr. Tyne and Dr. Jacob and cited the following contributions and statistics achieved under their guidance during their tenure:

- The customer service score independently measured and compared to our peers was 90 out of 100, which made the ASRS the second highest customer service pension fund in our peer group.

- The high customer service score was achieved with a below average cost model at 14.4 percent lower than our peers while still placing the ASRS in the top 10 percent in customer service.

- The ASRS instituted the Retrospective Rate Agreement (RRA) over the last five years, which allowed the ASRS, through its health insurance operations, to collect funds that otherwise would have been retained by the vendor. The collection of funds that alternatively would have been retained by the vendor, and which was paid for by retirees, is in excess of $100M and will be distributed in the future to the retirees.

- High focus on communications to ASRS members, which has further heightened staff’s focus as well so members feel more engaged.

Mr. Matson moved on to address the investment oversight by Mr. Connelly, who has been on the ASRS Board for approximately ten years and Professor Hoffman, who has been on the ASRS Board for approximately seven years, and cited the following contributions and statistics achieved under their guidance during their tenure.

- The internally calculated dollar values added by active or tactical investment decisions in comparison to the ASRS strategic asset allocation are as follows:
  - 1 year value added was $419 million
  - 3 years value added was $1.2 billion
  - 5 years value added was $1.4 billion
  - 10 years value added was $1.2 billion

- The internally calculated dollar values added by active or tactical investment decisions in comparison to the ASRS peers are as follows:
  - 1 year value added was $220 million
  - 3 years value added was $1.5 billion
  - 5 years value added was $2.3 billion
  - 10 years value added was $2.7 billion.
• The externally calculated rate of return for the ASRS compared to our peers for the 10-year period ending December 31, 2016, is in the 11th percentile, beating 89 percent of our peers' total fund rates of return.

• Post 2008, there was a lot of pressure on the ASRS Board and staff to de-invest in U.S. equities as well as equities in general. With the support of both Mr. Connelly and Professor Hoffman, the ASRS maintained and then increased its U.S. equity allocation while others were hesitant about U.S. equity exposure, which helped lead to the very strong ASRS performance post 2008.

• Mr. Connelly and Professor Hoffman had the ability to not only promote, but nurture innovative ideas with investment staff, including himself [Mr. Matson], which has consistently added significant value to the beneficiaries.

Mr. Matson stated that if he were asked to mention both positive and the negative attributes of these four Trustees, he would end up with a blank sheet on the negative attributes. The positive attributes, however, would be summarized as follows:

1. Integrity: The integrity that these four individuals have demonstrated is superior.
2. Professionalism: The professionalism that these four individuals have demonstrated is superior.
3. Member-Centric Focus: The member-centric focus that these four individuals have demonstrated is superior.
4. Fiduciary Standards: These four gentlemen epitomized the concept of the fiduciary, at the Board level, in committees, and in one-on-one dialogue.

Mr. Matson also noted that although the ASRS Deputy Director was unable to attend, he requested that the Director also convey his compliments and appreciation. Mr. Matson then turned to Mr. Karl Polen, Chief Investment Officer, to provide his comments regarding the departing Trustees.

Mr. Polen opened by stating that he’d like to echo Mr. Matson’s remarks and further emphasized the innovation and strengthening of the governance process in a way that has net-reduced bureaucracy. He stated this has allowed the agency to make significant decisions in shorter periods of time, which would not be possible without the contributions of Mr. Connelly and Professor Hoffman. He expressed his thanks and appreciation to all four departing Trustees for their contribution on the Board, especially Professor Hoffman and Mr. Connelly, with whom he’s had the pleasure to work closely with on the Investment Committee.

Mr. Clark Partridge took a moment to recognize the departing Trustees and stated that when he came onto the Board, he looked to the people who were on the Board, and these four gentlemen were great mentors to him. Mr. Partridge made reference to Mr. Matson’s earlier comments regarding the tough economic times that we’ve been in, stating, “It has been a protracted economic growth, but through it all, the ASRS has weathered the storm very well.” He went on to say, “Whenever you’re trying to weather a storm at sea, you need good hands on deck and people with perspective who can guide things safely, which these gentlemen have done.” Mr. Partridge stated that from the State Comptroller perspective, he appreciates public servants who commit to do good things for the state of Arizona and he thanked the departing Trustees for their service from that perspective. As an ASRS member, he thanked them for their contributions, dedication and commitment to always looking out for the members with a fiduciary responsibility. In closing, Mr. Partridge wished them well in all they do.

Mr. Tom Manos expressed it has been a pleasure to get to know all four gentlemen and he has learned a lot from each of them. Mr. Manos continued by first addressing Mr. Connelly and stated, “We couldn’t overestimate the value that you've added to the investment side of the house.” Mr.
Manos shared when he was appointed to the Board, he asked the Governor how much time it was going to take, and she responded “a couple of hours a month” and he has spent more than a couple hours a month. Mr. Manos stated he can’t imagine how much time Mr. Connelly spends with everything he’s done because this has been more than showing up to a meeting for him; this is Mr. Connelly’s passion. Mr. Manos further stated he was not surprised when Mr. Matson went through the numbers and was reminded Mr. Connelly didn’t just help add millions of dollars, but billions of dollars to the ASRS and doesn’t know how the ASRS could have functioned without Mr. Connelly’s expertise. Mr. Manos moved on to Professor Hoffman by stating he has been an enormous benefit in understanding the numbers. Professor Hoffman’s “ability to take numbers and processes that most of us would struggle to understand, and boil it down to the most important has been an enormous benefit” to all the members. Mr. Manos shared he has served on many Boards and has never met anyone that comes as well prepared to the meetings as Dr. Jacob. He could tell Dr. Jacob had read every word of the background material and that helped the Board get to better decisions. He expressed it’s been a pleasure to serve with Dr. Jacob on the Board. Mr. Manos stated that Mr. Tyne brings to the Board, common sense, great communication skills, and the ability to make all the members feel at ease when they come to Board meetings. Mr. Manos expressed that one of the most difficult tasks is acting as an Appeals Committee member. He stated that the way Mr. Tyne interprets the materials presented and making the members feel comfortable, no matter the outcome, making the members feel that they had a fair chance to present their side of the case, is an enormous benefit. Mr. Manos also commended Mr. Tyne for an outstanding job while fulfilling the role of Acting Chair for four or five months. Mr. Manos concluded by stating that in his prior career he used to say, “great employees start with great people” but he broadens that to say, “great Board members start with great people, and the four of you [departing trustees] are great people.”

Mr. Kevin McCarthy stated he couldn’t improve upon any of what’s been said, but he has had the pleasure of working on several different boards and commissions throughout his career, and as he’s watched these gentlemen moving on, he said, “my hope would be for those who are here now, we can maintain the level of collegiality and a focus on the real duty of the Board that these gentlemen brought to the table.” He reiterated what Mr. Matson stated earlier about the integrity and the focus on fiduciary responsibility that each Board member is charged with and stated each of them did a remarkable job in maintaining that. Mr. McCarthy went on to say he has never served on a board where the members check their biases at the door to the extent that this Board is able to do, and expressed that, “we’re all lucky that is the way this operation works.” He then thanked the departing Trustees not only for their friendship, but for their ability to do just that. Mr. McCarthy continued by stating it was easy to accept being reappointed to this Board largely because of that. The decisions are not easy to make, but each one of them that he has been involved in, were made for the right reasons. Mr. McCarthy closed by stating he joins everybody else in thanking them for their time and service and looks forward to seeing them in the future.

4. Approval of the February 24, 2017 Summary of Discussion by Non-Quorum ASRS Board Members, ASRS Staff, Presenters, and Public

Motion: Mr. Tom Manos moved to approve the February 24, 2017 Summary of Discussion by Non-Quorum ASRS Board Members, ASRS Staff, Presenters, and Public. Mr. Kevin McCarthy seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.
5. Presentation, Discussion, and Appropriate Action Regarding ASRS 2017 Legislative Initiatives and Legislative Update

Mr. Nick Ponder, Government Relations Officer, provided an update regarding the 2017 Legislative Session. Mr. Ponder noted it is the 110th day of this Legislative Session and in recent weeks a lot of the focus has been on the budget. He also noted there are 39 bills left awaiting a vote or conference committees. Two of those bills are ASRS bills, however, Mr. Ponder stated there is no reason to be concerned.

The following ASRS bills were discussed:

- **HB2166: ASRS; Return to Work** – This bill removes the language “in a position ordinarily filled by the employee of the employer” from A.R.S. § 38-766.02, as it relates to charging an employer an alternate contribution rate when hiring an ASRS retiree. The current statutory language creates an opportunity for a loophole if employers choose to lease specific classes of employees. This bill passed on final reading 48 to 8. It is ready for the Governor’s signature.

- **HB2167: ASRS; Contributions; Adjustments** – This bill offers proposed language to A.R.S. § 38-738(A) & (B) to confirm with clarity to the Internal Revenue Code regarding how the ASRS would process not only employer credits, but contributions not withheld and requests for contributions not withheld on forfeited membership from members returning to work for an ASRS employer. This bill moved to the Senate Finance Committee. The final vote is expected after the budget agreement.

- **HB2168: ASRS; Reinstatement; Contribution Amount** – This bill modifies the language in A.R.S. § 38-742(B) to indicate a member reinstating their service must repay the amount the “ASRS paid” rather than the amount the “member received.” This bill moved to the Senate Finance Committee. The final vote is expected after the budget agreement.

- **SB1052: ASRS; Optional Retirement Benefits; Overpayment** – This bill modifies the language in A.R.S. § 38-760(B)(3) to allow the ASRS to collect an overpayment from a member’s Partial Lump Sum distribution before rolling the remaining monies into a qualified plan upon retirement. In addition, it allows the ASRS to collect an overpayment from a member’s refund distribution before rolling the remaining monies into a qualified plan. This bill passed in the House on March 21, 2017, and was signed by the Governor on March 29, 2017.

- **SB1053: ASRS; Board Powers** – This bill modifies the language in A.R.S. § 38-714 to permit the ASRS Board to establish a committee of the Board for the purposes of determinations following an administrative hearing for the Long Term Disability statutes in Article 2.1, in addition to transfers in Article 7. When A.R.S. § 38-714 was amended in 2016, it only included Article 2. The passage of this bill would permit the Appeals Committee to hear all appeals under ASRS articles. This bill passed in the House on March 21, 2017, and was signed by the Governor on March 29, 2017.

- **SB1178: ASRS; Nonparticipating Employers; Liability** – This bill modifies the language in A.R.S. § 38-751 to update and broaden the definition of a nonparticipating employer for purposes of charging a liability; to provide clarity regarding how the ASRS actuary would calculate a nonparticipating employer’s liability; and indicates the employer and employee contribution rate would remain the same as the plans’ with the employer being invoiced an additional amount annually to account for their share of the liability. This bill was carried over from last year. It has been held in the House in order to have meetings with stakeholders following the 2017 session. The sponsor is using the bill as a vehicle for a striker in the House and any action following February 22, 2017, is indicative of non-ASRS related actions.
The following are bills that affect the ASRS but not initiated by the ASRS:

- **HB2010: ASRS; Political Subdivision Entities** – This bill, if passed, would exclude membership in the ASRS of new employees of political subdivision entities. Employees who are currently members of the ASRS and become employed with a political subdivision entity will maintain their membership in the ASRS. The ASRS has identified 15 employers that would be impacted by this bill. This bill was not third read in the House and the sponsor has indicated she does not have the requisite votes to move forward.

- **HB2169: ASRS; State Retirement; Waiting Period; Repeal** – This bill, if passed, would remove the 6-month waiting period for participation in the ASRS for state employees. This bill was not heard in the Appropriations Committee prior to the committee deadline and is dead this legislative session.

Mr. Ponder responded to questions from the Board.

### 6. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Program Updates

Mr. Karl Polen, Chief Investment Officer, addressed the Board regarding the ASRS investment program updates for the period ending December 31, 2016, highlighting specific areas of interest and concern. Mr. Polen presented information on the following items: ASRS Fund Positioning, Investment Management Division (IMD) Investment House Views, IMD Projects, and Asset Class Committee Activities and the Risk Report. Mr. Polen informed the Board the ASRS has changed from using State Street to MSCI Inc. for the risk report. Mr. Polen further reported that MSCI provides a better matrix at a cost savings of approximately $140,000 per year. Mr. Polen responded to questions from the Board.

### 7. Presentation, Discussion, and Appropriate Action Regarding Independent Reporting Monitoring, and Oversight of the ASRS Investment Program – Includes Total Fund Q4 -16

Mr. Don Stracke, Consultant, NEPC, addressed the Board regarding NEPC’s independent reporting, monitoring, and oversight of the ASRS Investment Program including Total Fund performance through December 31, 2016.

As of December 31, 2016, the Total Fund’s market value was approximately $35.1 billion.

For the one-year period ending December 31, 2016, the Total Fund returned 8.1% (net of fees), underperforming the Interim SAA Policy by 0.7%. For the three-year period, the Total Fund produced a return of 5.2 per annum, outperforming the Interim SAA Policy by 1.0%. Over the past ten years, the Total Fund has returned 5.5% per annum, and since inception, the portfolio’s performance is 9.7%.

Discussion ensued regarding the actual rate of return (7.2%) vs. the target (8%) rate of return. Mr. Matson explained the expected rate of return post 2008 and how it is determined, and how it is related to various actuarial outcomes. He further emphasized the ASRS takes a somewhat different approach in constructing portfolios than many other funds, in that we are very long-term oriented and we significantly de-link assets and liabilities. Mr. Partridge commented on the importance of being careful not to make sharp course corrections, as it could be dangerous. Keeping a good sustained long term view is important.
8. Presentation, Discussion, and Appropriate Action Regarding a Revised Strategic Asset Allocation (SAA) for the Long Term Disability (LTD) Program and Modifications to the SAA and Tactical Repositioning and Rebalancing Policies for the Pension, Health Benefit Supplement System, and LTD Programs

Mr. Paul Matson provided a high level presentation on the LTD program and presented the proposed revision to the SAA for LTD assets in combination with revisions to the strategic investment policies for the Pension, Health Benefit Supplement (HBS), and System assets (collectively the “Plans”), in order to achieve greater diversification, lower investment costs, improved operational efficiency and improved liquidity.

Motion: Mr. Harry Papp moved to approve the proposed Strategic Asset Allocation (SAA) for the LTD Program and modifications to the SAA and Tactical Repositioning and Rebalancing Policies for the Pension, Health Benefit Supplement, System, and LTD Programs, as presented and recommended by staff as follows:

1. Approve the Proposed SAA for LTD (as presented in the attached exhibit). The proposed changes reflect an allocation to the same asset classes and percentages as the Plans’ SAA, which was approved by the Board on March 27, 2015.
2. Amend SIP001 and SIP002 (as presented in the attached exhibits), providing that investments of LTD and System assets, and rebalancing determinations will be made in accordance with the asset allocation guidelines utilized by the Plans.
3. Repeal SIP003, SIP004, SIP008 and SIP009 which provided separate/redundant investment policies for LTD and System assets.

Mr. Tom Manos seconded the motion.

By a vote of 6 in favor 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

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

Mr. Paul Matson introduced the topic indicating the Director’s Report includes a variety of metrics in various areas, such as customer service and is generally provided for informational purposes each month. However, for the benefit of the Board members, Mr. Matson asked Mr. Dave King, Assistant Director, Member Services Division, to review the monthly Operations Report. Mr. King highlighted the following:

- 80% of the calls are answered within 20 seconds or less.
- The Call Center receives approximately 170,000 calls per year which is down from 250,000 calls six years ago. This has just started to rise again due to added security features.
- Unusually high turnover in 2016 caused the Call Center to miss meeting their timeliness goals.
- Member satisfaction with calls answered is high.
- Member secure messaging volume is up.
- Timeliness responding to emails is down, however, remains good.
- One-on-One Counseling (walk-ins) is down approximately 50%.
• Member satisfaction is high regarding member meetings.
• Benefit estimates are down as members can perform this online at any time.
• Service purchase volume is down.
• Refunds are declining, however member satisfaction and timeliness is still high.
• New retirements are consistent. The goal is to ensure retirees experience no interruption in income and this does occur with few exceptions.
• Survivor benefits are timely.
• Website transactions are up due to 75% of what a member wishes to do, they can do it on the secured website themselves.

Mr. Michael Miller thanked Mr. King and the ASRS as he himself is a recipient of the benefits offered to ASRS members. Mr. Miller shared that he and his wife have always been very well received when coming into the ASRS and received immediate service and responses online as well.

Mr. Jim Hillyard expressed how impressed he was with the metrics that are being collected and feels the ASRS is measuring the right things and complimented Mr. King on the presentation. Mr. Hillyard was specifically interested in service purchase as there was an indication of dissatisfaction and asked for the reasons behind this rating. Mr. King explained, the cost is a factor and members tend to roll this into the customer service satisfaction survey. The ASRS is looking into ways of separating this so the member is answering based on their satisfaction with the customer service and not the cost factor. Ms. Jothi Beljan, Assistant Attorney General, offered further clarification by indicating that in most cases members are relying on a third-party rollover to buy back their service and some institutions can be more difficult than others to work with and the member attributes this to the ASRS rather than the third party who caused the delays. This would also be the same with regard to Payroll Deduction Agreements.

Mr. Tom Manos left the meeting at 10:25 a.m.

10. Presentation and Discussion Regarding Informational Updates from Prior and Upcoming Committee Meetings

Mr. Matson suggested foregoing the discussion of agenda item #10 as there are currently no committee membership assignments with the recent changeover in Trustees, and any scheduled meetings in May 2017 will likely be canceled.

11. Board Requests for Future Agenda Items

No requests were made.

12. Call to the Public

A member of the public, Mr. Joe Geusic, requested to address the Board.

Prior to Mr. Geusic addressing the Board, Ms. Beljan reminded the Board that if the topic Mr. Geusic is speaking on is not on today’s agenda, the Board is limited to responding to criticism, asking staff to review the matter, or placing the topic on a future agenda.
Mr. Geusic stated he is an advocate for the K-12 system and made general comments with regards to contribution rates that have risen over the years and the impact on members of the K-12 system and the programs it is able to offer. Mr. Geusic was appreciative of Mr. Matson’s earlier presentation regarding the rates, statutes, etc. and indicated he would like to know more of the history. Mr. Matson invited Mr. Geusic to stay after the meeting to talk about his concerns with Mr. Matson and Mr. Geusic accepted.

13. The next regular ASRS Board meeting is scheduled for Friday, May 26, 2017, at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board Room, Phoenix, Arizona.

14. Adjournment of the ASRS Board

Motion: Mr. Clark Partridge moved to adjourn the April 28, 2017, Board Meeting at 10:30 a.m. Mr. Jim Hillyard seconded the motion

By a vote of 5 in favor 0 opposed, 0 abstentions, 3 excused, and 1 vacancy, the motion was approved.

Respectfully Submitted by:

Alicia Guzman
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM