



ARIZONA STATE RETIREMENT SYSTEM

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Paul Matson
Director

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

Friday, December 4, 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 8:31 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, Vice Chair
Mr. Clark Partridge (via teleconference)
Professor Dennis Hoffman
Dr. Richard Jacob
Mr. Robert Wadsworth
Mr. Tom Connelly
Mr. Tom Manos (arrived at 9:35 a.m.)

Absent: Mr. Lorenzo Romero

A quorum was present for the purpose of conducting business.

2. Presentation Regarding PRIDE Award for Diversity

Mr. Dave King, Assistant Director, Member Services, recognized the following nominees for the 2015 PRIDE Diversity award: Valerie Burkett; Management Support Services – Gayle Williams, Gloria Trujillo, Melanie Alexander, Courtney Micheau, Alicia Guzman; Member Education Team and Tucson Meetings BAs – Ben Robinson, Carol English, Tara Fair, Marina Keith, Rose Busse, Brandi Clemans, Kimberly Beck, Lupita Higuera, Jane Hennessy, Jose Palmer, and Dennis Griggs, with the assistance of Patrick Toto, Frank Perry, Gary Rodriguez, Julie Lockwood and Dave King; and the Work Environment Team – Brian Thompson, Cincy Gould, Donna McNally, Gayle Williams, Jana George, Jane Hennessy, Jenalee Hopkins, Judy Simpson, Kim Beck, Krystal Mungia-Olivarez, Lisa King, Matthew Herman, Melanie Alexander, Rose Busse, Teresa Donohue, Ted Kistner, Wendy Tobin.

The nominees were recognized by their peers as exemplifying the following PRIDE qualities of diversity:

- An attitude of openness to encourage a free flow of ideas and opinions
- Working effectively to accomplish goals with teams comprised of dissimilar individuals or groups
- Recognizing and promoting new skills in others attained on and off the job to achieve desirable results
- Treating others different from you with dignity and respect

Mr. King presented the PRIDE Award for Diversity to the award winner, Valerie Burkett.

3. Approval of the Minutes of the October 30, 2015 Public Meeting of the ASRS Board

Motion: Prof. Dennis Hoffman moved to approve the Minutes of the October 30, 2015 Public Meeting of the ASRS Board. Mr. Jeff Tyne seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

Prior to moving to Agenda Item #4, Mr. Kevin McCarthy announced a modified order of the agenda and indicated that as the Board progresses through the agenda, if necessary, determinations may be made to move some agenda items to the January 29, 2016 meeting.

4. Presentation, Discussion, and Appropriate Action Regarding the ASRS Proposed Legislation for the 2016 Legislative Session

Mr. Patrick Klein, Assistant Director, External Affairs Division, and Mr. Nick Ponder, Government Relations Officer, provided a brief update to the Board regarding the 2016 Legislative agenda. Mr. Klein announced the ASRS has secured sponsorship for the seven initiatives approved by the Board at the September 25, 2015 meeting. Since that meeting, there have been two additional initiatives approved by the External Affairs Committee which Mr. Ponder will summarize for the Board.

Mr. Ponder presented the Board with the two newly proposed 2016 legislative initiatives as recommended by the External Affairs Committee (EAC):

A.R.S. § 38-747(H): Purchase of credited service; payment; limitations; definitions- The ASRS would like to limit the purchase of credited service meaning the ASRS would only accept direct rollovers from a qualifying plan. Currently, the ASRS allows for an indirect rollover; however, allowing indirect rollovers can present tax issues for participants as they could be ultimately double taxed by unknowingly marking the wrong box in the disclaimer.

A.R.S. § 38-738(B): Adjustment and refund- The ASRS would like to clarify in law that a person who has forfeited membership in the ASRS but who returns to work for an ASRS employer cannot request a Contributions Not Withheld for any period of employment prior to the members most recent date of membership. Currently, it could be interpreted that by returning to active status, the member has CNW rights in A.R.S. 38-738 for employment prior to the member's most recent ASRS membership date.

Mr. Ponder opened the discussion to questions from the Board. Mr. McCarthy requested that Mr. Ponder provide an update regarding the University proposal that would remove the Arizona State University from the ASRS. Mr. Ponder stated that he has had discussions with legislative staff with respect to the university issue, and it is his belief it will be heard in Committee this

year. It may not have the votes necessary to pass through the 2016 Legislative Session. However, with the upcoming change in leadership that will be present in the 2017 Legislative Session, the leadership may be more favorable toward a university departure from the ASRS. With this in mind, it is imperative that the ASRS and the Board discuss the cost of withdrawal and possibly provide language to the legislature with respect to how that cost would be determined.

Motion: Dr. Richard Jacob moved to approve the two additional 2016 legislative initiatives as presented by staff, permit staff to make all language changes, and negotiate as necessary to obtain the most effective and efficient legislative provision within the construct of today's discussion. Mr. Jeff Tyne seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

5. Presentation, Discussion, and Appropriate Action Regarding the Arizona State Retirement System's Comprehensive Annual Financial Report (CAFR) for Fiscal Year 2015

Mr. Jason Ostrosky, CliftonLarsonAllen Audit Manager, introduced himself to the Board. Mr. Ostrosky spoke on behalf of CliftonLarsonAllen, LLP, the ASRS' external auditor. Mr. Ostrosky opened the discussion by commending the ASRS accounting staff. The implementation of the Government Accounting Standards Board (GASB) 68 this year and the many changes with GASB 67 last year has created a significant amount of additional work for the staff and he felt they should be recognized.

Mr. Ostrosky presented an unmodified Independent Auditor's opinion for the fiscal year ending June 30, 2015, on the ASRS financial statements that collectively comprise the ASRS' financial statements in the Comprehensive Annual Financial Report (CAFR). In addition, he provided a brief overview of the results of the 2014 GASB 68 schedules audit and a status update on the 2015 GASB 68 schedules.

Mr. Ostrosky responded to questions from the Board.

Mr. Paul Matson, Director, and members of the Board, took a moment to recognize Ms. Nancy Bennett, Chief Financial Officer, Ms. Erin Higbee, Assistant Controller, and ASRS accounting staff for their fine work and for supporting this effort.

Motion: Dr. Richard Jacob moved to adopt the 2015 Comprehensive Annual Financial Report and congratulate those responsible for having to prepare it and brought about the results described therein. Mr. Jeff Tyne seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

6. Presentation, Discussion, and Appropriate Action Regarding ASRS Valuations, including Potential Implementation of Actuarial Audit Recommendations

Mr. David Kershner, Actuary, Buck Consultants, and Mr. David Driscoll, Actuary, Buck Consultants, summarized the ASRS valuations.

a. The ASRS System Valuation and Actuary's Recommendation Regarding 13th Checks for Retired System Members

The Actuaries provided information regarding the non-retired census data, retiree census data, liabilities and funded status for the System. The funded status for the System as of June 30, 2015, was reported as 79.62%, a decrease from 2014, which is due to returns below 8% on the assets. By prior Rule, the Board does not increase benefit levels when funded status is below 105%; therefore, no additional 13th checks or additions to current 13th checks are recommended this year. All current 13th checks will continue to be paid.

b. The ASRS Pension Plan and Health Insurance Valuation

The Actuaries addressed the Board regarding the ASRS Pension Plan and Health Insurance and presented charts summarizing the contribution rates and the funded status. The combined contribution rate dipped slightly from 22.70% to 22.67%, which will be effective July 1, 2016. The market value funded status was reported as 78.78%, a decrease from 2014, and the actuarial value was reported as 77.53%, an increase from 2014. The Actuaries also presented their analysis of implementing recommendations resulting from the Actuarial Audit performed by Gabriel Roeder Smith & Company (GRS) (presented to the Board June 27, 2014). The analysis remained consistent with the analysis conducted in 2014, which concluded the annual effects of not implementing the recommendations are relatively minor.

Scenario	(1) Current Valuation Results	(2) Include Historical Pay, New Entrants in Normal Cost, and 5 Year Amortization of Contribution Lag	(3) Include Historical Pay, Phasing in New Entrants in Normal Cost over 3 years, and 5 Year Amortization of Contribution Lag	(4) Scenario (2) including Large Benefit Adjustment in Mortality Rates for all Actives and DV's
Total Contribution Rate	22.67%	23.12%	22.89%	23.67%
Funded Status – Actuarial Value of Assets	77.53%	77.42%	77.42%	76.83%
Funded Status – Market Value of Assets	78.78%	78.67%	78.67%	78.07%

In response to questions from the Board, Mr. Matson stated that his recommendation would be to wait until the 2017 Actuarial Experience Study is completed before considering the implementation of the GRS recommendations, unless it is determined the current contribution rates are too conservative and therefore fall faster than expected, then an earlier decision may be appropriate.

c. The ASRS Long Term Disability (LTD) Valuation

The Actuaries addressed the Board regarding the ASRS the LTD Valuations. The actuaries also presented their pro-forma analysis of implementing recommendations resulting from the Actuarial Audit performed by GRS. The contribution rate increased from .12% in 2014, to .14% in 2015, which will be effective July 1, 2016.

d. The ASRS Alternate Contribution Rate (ACR)

Mr. Kershner and Mr. Driscoll addressed the Board regarding the ASRS aggregate results and

Alternate Contribution Rate (ACR) which is the amount employers pay when they rehire retired ASRS members. The calculated ACR is 9.47%.

Mr. Tom Manos arrived during the discussion of Agenda Item #6 and did participate in the following votes.

Mr. Clark Partridge was temporarily unavailable during the discussion of Agenda Item #6 and did not participate in the following votes.

Motion: Dr. Richard Jacob moved to accept the System actuarial valuation as presented. Prof. Dennis Hoffman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

Motion: Prof. Dennis Hoffman moved to accept the actuarial valuation report of the Plan with the resulting contribution rates 11.34% for each the employee and employer as presented with the current actuarial assumptions and reconsider the 2013 audit recommendations during the completion of the next experience study. Mr. Jeff Tyne seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

Motion: Mr. Jeff Tyne moved to accept the actuarial valuation report of the LTD program with the resulting contribution rates of 0.14% for each the employee and employer as presented with the current actuarial assumptions. Prof. Dennis Hoffman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused the motion was approved.

Motion: Dr. Richard Jacob moved to accept the Alternate Contribution Rate of 9.47% as presented with the current actuarial assumptions. Prof. Dennis Hoffman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused the motion was approved.

7. Approval, Modification, or Rejection of Recommended Administrative Law Judge's Decision Regarding the Griffin Foundation Appeal Regarding Delinquent ASRS Contributions from October 24, 2010 to Present (*This agenda item was taken out of order and was formerly listed as agenda item #11.*)

Mr. Christopher Munns, Assistant Attorney General, Solicitor General Section, was present via teleconference to provide legal advice to the Board, if requested.

Mr. Kraig Marton, Attorney representing Griffin Foundation, Inc. (GFI), was present and addressed the Board regarding GFI's position. Mr. Marton opened the discussion by requesting that the Board provide GFI the guidance now that he does not believe it did in the last five years regarding what constitutes a leased employee. In addition, Mr. Marton stated that GFI acted in good faith and asked that the Board not accept the Recommended Decision.

Ms. Jothi Beljan, Assistant Attorney General, presented the ASRS position to the Board and restated the facts of the case. Ms. Beljan reiterated that employers owe contributions for the employer and its members. She directed the Board to A.R.S. § 38-711, specifically paragraph 23, which contains the definition of a "member" that states in part, "means any employee of an employer on the effective date." Ms. Beljan stated that although the appellant considers this a technical difference, it is a legal and factual difference because the contracts with GFI and

Insperty, and later ADP, clearly state at all times that GFI was an employer of those individuals performing services at GFI.

Mr. Marton and Ms. Beljan responded to questions from the Board.

Motion: Dr. Richard Jacob moved to accept the Administrative Law Judge's Decision with the following modifications:

- a) Correct the typographical error in Finding of Fact No. 3 citing A.R.S. § 38-797(5) with the correct statutory citation of A.R.S. § 38-797.05.
- b) Change "November 2010" in Conclusion of Law No. 8 to "October 24, 2010" based on Finding of Facts No. 6 and 33.

Prof. Dennis Hoffman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

8. Presentation, Discussion, and Appropriate Action Regarding the review of the Director and Employment Contract for the Director (*This agenda item was taken out of order and was formerly listed as agenda item #18.*)

Motion: Mr. Tom Manos moved to go into Executive Session for the purpose of the Director's review and employment contract. Dr. Richard Jacob seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

The Board convened to Executive Session at 11:18 a.m.

The Board reconvened to Public Session at 12:11 p.m.

9. Presentation, Discussion, and Appropriate Action Regarding an Annual Update on Strategic Plan Priority #3 in the ASRS 5-Year Strategic Plan: Optimize Investment Organization and Strategies

Mr. Paul Matson provided the Board with an executive summary of this topic with input from Mr. Gary Dokes, Chief Investment Officer. In summary, to achieve desired results and optimize the investment organization, the following subcomponents were established to assist in measuring performance:

- A. Design an organizational, staff, and consultant model that is congruent with the current, and forward-looking, relevant investment market place - outlook changed from neutral to positive in 2014 to positive in 2015.
- B. Develop a program to retain and attract top investment related staff - outlook changed from neutral in 2014 to neutral to positive in 2015.
- C. Implement investment strategies and manage returns for given levels of risk - outlook changed from neutral to positive in 2014 to positive in 2015.

Based on the 2015 review results, the ASRS is progressing toward meeting its objectives.

10. Presentation, Discussion, and Appropriate Action Regarding an Annual Update on Strategic Plan Priority #1 in the ASRS 5-Year Strategic Plan: Ensure Plan Sustainability

Mr. Paul Matson provided the Board with an executive summary of this topic with input from Mr. Patrick Klein and Ms. Sara Orozco, Manager, Strategic Planning and Analysis. Mr. Matson explained that each plan was looked at based on size, from largest to smallest as follows: Defined Benefit Plan, Health Insurance Program and Health Benefit Supplement, System (closed to new participants), Long Term Disability Program, and the Optional Supplemental Defined Contribution Plans. Mr. Matson felt it was important to start by stating what sustainability means to the ASRS staff and read the following: "Sustainability means the ability to continue to offer current programs in substantially constant forms but allowing for modest modifications in such a manner as program costs are not volatile and are generally affordable to employees and employers over time."

The outlook results of the review to ensure the ASRS is meeting its objectives in ensuring plan sustainability are as follows:

- A. Defined Benefit Plan - outlook remained neutral to positive for both 2014 and 2015.
- B. Health Insurance Program and Health Benefit Supplement - outlook remained positive for both 2014 and 2015.
- C. Long Term disability Program - outlook remained positive for both 2014 and 2015.
- D. System - outlook remained neutral to positive for both 2014 and 2015.
- E. Optional, Supplemental Defined contribution Plans - outlook changed from positive in 2014 to neutral to positive in 2015.

Mr. Matson concluded the presentation by stating that the plan is sustainable and if there was an area that needed to be closely monitored, it would be the Defined Benefit Plan because it has the largest contribution rate and the lowest funded status.

11. Presentation and Discussion Regarding the Board Self-Evaluation Material Distribution *(This agenda item was taken out of order and was formerly listed as agenda item #12.)*

Mr. McCarthy addressed the Board regarding the Board self-evaluation material, noting Trustees should submit their Board performance evaluation forms to him prior to the January Board meeting.

12. Presentation, Discussion, and Appropriate Action Regarding ASRS Investment Program Updates *(This agenda item was taken out of order and was formerly listed as agenda item #7.)*

Mr. Gary Dokes, Chief Investment Officer, and Mr. Dave Underwood, Assistant Chief Investment Officer, were present to provide the Board with an update on the Investment Program.

Mr. Dokes directed the Board to page three of the reference materials that shows how the assets are deployed. Mr. Dokes went on to say the ASRS feels this is the best deployment of assets to achieve the long term rate of return in the desired risk profile. This has been accomplished efficiently by way of in-house management and other vehicles the ASRS believes are as cost efficient as possible. Mr. Dokes highlighted one difference from the chart compared

to the most recent charts the Board has seen and that was with the multi-class asset which shows a -1.7%. Mr. Dokes explained the reason for this is there used to be two multi-class asset managers, one was terminated, which left an underweight in this area. This will likely be kept underweight for a while.

Mr. Dokes moved on to the next chart and highlighted that the ASRS is underweight in fixed income which is made up of many types of investments. Some are interest rate sensitive and high yield which the ASRS is underweight in. The ASRS is overweight in opportunistic debt and populating private debt allocation which is the place to be in fixed income. The ASRS will continue to monitor this.

13. Presentation, Discussion, and Appropriate Action Regarding Independent Reporting, Monitoring, and Oversight of the ASRS Investment Program, Including Total Fund and Investment Performance Report for Q3-15 *(This agenda item was taken out of order and was formerly listed as agenda item #8.)*

Mr. Allan Martin, Consultant, NEPC, addressed the Board regarding NEPC's independent reporting, monitoring, and oversight of the ASRS Investment Program including Total Fund performance through September 2015. As of September 30, 2015 the Total Fund's market value was approximately \$33.0 billion.

For the one-year period ending September 30, 2015, the Total Fund returned -0.2% (net of fees), outperforming the Interim SAA Policy by 1.3%. For the three-year period, the Total Fund produced a return of 8.0% per annum, outperforming the Interim SAA Policy by 1.1%. Over the past ten years, the Total Fund has returned 6.0% per annum, and since inception, the portfolio's performance is 9.7%.

14. Presentation, Discussion, and Appropriate Action Regarding the Director's Report as well as Current Events *(This agenda item was taken out of order and was formerly listed as agenda item #13.)*

Mr. Paul Matson stated he had nothing further to add regarding the Director's Report but would answer any questions the Board may have regarding the report. No questions were asked.

15. Presentation and Discussion with Respect to Informational Updates from Prior and Upcoming Committee Meetings *(This agenda item was taken out of order and was formerly listed as agenda item #14.)*

a. Operations and Audit Committee (OAC)

Mr. Jeff Tyne announced the next OAC meeting will be held on December 9, 2015 at 10:30 A.M. in the 14th floor conference room to discuss recently conducted audits, some current initiatives, and an update on the Web Steering Committee.

b. External Affairs Committee (EAC)

Dr. Richard Jacob announced the next EAC meeting will be held on February 12, 2016 at 10:30 A.M. in the 14th floor conference room to receive an update on the opening of the 2016 Legislative Session, review the status of the ASRS initiatives and other legislation that may impact the ASRS and receive a rulemaking update.

c. Investment Committee (IC)

Mr. Tom Connelly announced the next IC meeting will be held on February 22, 2016 at 2:30 P.M. in the 14th floor conference room to review investment program updates, program oversight, the fourth quarter performance report and an overview of the equity asset class.

16. Board Requests for Agenda Items (*This agenda item was taken out of order and was formerly listed as agenda item #15.*)

No requests were made.

17. Call to the Public (*This agenda item was taken out of order and was formerly listed as agenda item #16.*)

No one from the public requested to speak.

18. The next regular ASRS Board meeting is scheduled for Friday, January 29, 2016, at 8:30 A.M., at 3300 N. Central Avenue, 10th Floor Board Room, Phoenix, Arizona. (*This agenda item was taken out of order and was formerly listed as agenda item #17.*)

19. Adjournment of the ASRS Board

Motion: Dr. Richard Jacob moved to adjourn the December 4, 2015 Board Meeting at 1:02 P.M. Mr. Jeff Tyne seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

ARIZONA STATE RETIREMENT SYSTEM

Melanie A. Alexander
Board Administrator

Paul Matson
Director