



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO Box 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
4400 EAST BROADWAY BOULEVARD • SUITE 200 • TUCSON, AZ 85711-3554 • PHONE (520) 239-3100
TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1 (800) 621-3778
AZASRS.GOV

Paul Matson
Director

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

Friday, July 26, 2019
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. Jim Hillyard, Chair of the ASRS Board, called the meeting to order at 8:32 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. Jim Hillyard, Chair
Mr. Clark Partridge, Vice-chair (Via teleconference)
Mr. Rene Guillen (Via teleconference)
Mr. Tom Manos (Via teleconference)
Mr. Kevin McCarthy
Mr. Michael Miller

Excused: Mr. Michael Lofton

Two vacant positions.

A quorum was present for the purpose of conducting business.

2. Approval of the Minutes of the May 31, 2019 Public Meeting of the ASRS Board

Motion: Mr. Kevin McCarthy moved to approve the minutes of the March 29, 2019 Public Meeting of the ASRS Board. Mr. Michael Miller seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved
Mr. Clark Partridge – approved
Mr. Rene Guillen – approved
Mr. Michael Lofton – excused
Mr. Tom Manos – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

- 3. Presentation, Discussion, and Appropriate Action Regarding ASRS Budget-Related Topics, including:**
- a. Presentation/update of the ASRS Appropriated and Continuously Appropriated Budget Plans to include the ASRS Administrative and Investment Spending Plans for FY 2020.**
 - b. Presentation of the ASRS Appropriated and Continuously Appropriated Budget Request and the ASRS Administrative and Investment Spending Plans for FY 2021.**

Ms. Martha Rozen, Chief of Administrative Services, opened the discussion by introducing the team of staff responsible for the materials being presented to the Committee. Ms. Rozen provided a summary of the discussion ahead stating the budget and spending plans submissions focus on Strategic Priority #4: Optimizing Operational Effectiveness, as well as support all the strategic priorities by ensuring resources. Ms. Rozen turned the presentation over to Mr. Chris Gustafson, Budget and Procurement Manager.

Mr. Gustafson reviewed the budget recommendation with the Committee. Mr. Gustafson highlighted the following:

- Budget includes key performance indicators to reduce the base administration budget by 3% between FY 2017 and FY 2021. The agency has not only met that goal but has exceeded it.
- The projection for FY 2020 is that the base administration expenditures will decrease by approximately 3.8%.
- FY 2020 and FY 2021, the agency identified two significant priorities that will be the basis of the spending plan.
 - Data, transactional and network security
 - Information technology applications development and infrastructure architecture enhancements
- The ASRS is currently undertaking three new projects in addition to two ongoing projects.
 - Benefits Disbursements
 - Automation upgrades in Oracle Modernization
 - Information Protection Security
 - Technology Improvement (ongoing)
 - Risk Mitigation (ongoing)

Mr. Gustafson responded to questions from the Committee and turned the presentation over to Ms. Kerry White, Assistant Chief Investment Officer, to review the Investment Spending Plan as follows:

- The bulk of the requested budget is for management fees in public and private markets
- Only used approximately 36% of the projected costs for management fees with the prior year's move from active portfolio management to passive portfolio management

Ms. White responded to questions from the Board.

Motion: Mr. Michael Miller moved to approve the following:

- 1) An appropriated budget request for FY 2021 in the amount of \$24,194,000, with an understanding there may ultimately be changes to the total appropriated budget amount due to legislative and executive recommendations.

Mr. Kevin McCarthy seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved
Mr. Clark Partridge – approved
Mr. Rene Guillen – approved
Mr. Michael Lofton – excused
Mr. Tom Manos – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

Motion: Mr. Michael Miller moved to approve the following:

- 2) The proposed administrative spending plan of \$30,033,300 and continuously appropriated investment spending plan of \$138,267,200 for FY 2021 subject to revised management projections, and to include private markets performance incentives and other fees when identified and paid.

Mr. Kevin McCarthy seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved
Mr. Clark Partridge – approved
Mr. Rene Guillen – approved
Mr. Michael Lofton – excused
Mr. Tom Manos – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

4. Presentation, Discussion and Appropriate Action Regarding the Actuarial Audits of the:

- a. Pension Plan
- b. Health Benefit Supplemental Program
- c. Long Term Disability (LTD) Plan

Mr. Paul Matson, Director, introduced the item by explaining the roles of an actuarial valuation, actuarial experience study, and actuarial audit. He then stated that the ASRS conducts an actuarial audit every five years. The current actuarial audit is of the actuarial valuations for the Pension Plan, the Health Benefit Supplemental Program, and the LTD Plan for the year ending June 30, 2018, and was completed by Segal Consulting. Gabriel Roeder Smith & Company (GRS) Representatives Mr. Ryan Falls, Senior Consultant and Actuary, and Mr. Paul Wood, Consultant and Actuary, attended the Board meeting via teleconference. Mr. Brad Ramirez, Vice President & Consulting Actuary, Segal Consulting, the contracted ASRS Actuary, provided Segal's findings to the audit.

Mr. Matson suggested that the Board consider implementing three items with the June 30, 2019 valuation and future years that Segal had suggested the Board consider during the next experience study as follows:

- 1) Implement a 25 year amortization period for future experience that impacts new actuarial accrued unfunded liabilities,
- 2) implement a 30% corridor where the actuarial value of assets is limited to be within 70% and 130% of the market value of assets, and

3) consider including recent experience in the phase-in method for contribution rate calculations,
and further study these and the remainder of the items recommended for consideration in the actuarial audit during the next actuarial experience study.

Mr. Matson turned the presentation over to Mr. Ramirez, who reviewed the findings of the actuarial audit with the Board. Mr. Ramirez noted the cooperation extended by GRS, as well as by ASRS staff. The Audit Summary of Results was: "Our audit confirms that the results of the actuarial calculations as of June 30, 2018 are reasonable, and that those calculations are based on generally accepted actuarial principles and practices."

Mr. Ramirez and Mr. Matson answered multiple questions from the Trustees regarding the actuarial audit.

Motion: Mr. Kevin McCarthy moved to implement beginning with the June 30, 2019 valuation, the following:

- 1) Implement a 25 year amortization period for future experience that impacts new actuarial accrued unfunded liabilities,
- 2) implement a 30% corridor where the actuarial value of assets is limited to be within 70% and 130% of the market value of assets, and
- 3) consider including recent experience in the phase-in method for contribution rate calculations,

and further study these and the remainder of the items recommended for consideration in the actuarial audit during the next actuarial experience study.

Mr. Michael Miller seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved
Mr. Clark Partridge – approved
Mr. Rene Guillen – approved
Mr. Michael Lofton – excused
Mr. Tom Manos – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

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

Mr. Karl Polen, Chief Investment Officer, prefaced his report with a brief review of current financial trends, stating that U.S. interest rates, while low by historic standards, are higher than the rest of the developed world. Partly due to the higher U.S. rates, the dollar has been appreciating, putting pressure on global finance and trade. Policy uncertainty, here and abroad, is adding additional pressure and global stock markets have traded off their highs achieved in the last eighteen months. The sole exception to this trend is in U.S. large cap stocks, which recently set a new high. In light of these conditions, ASRS remains slightly underweight global stocks and underweight interest rate sensitive securities, maintaining a small position in cash.

Reporting on the goals set by the Board, the portfolio is meeting all of the investment objectives set by the Board including ranking with other public pension funds, asset class returns and cash availability.

For periods ended June 30, 2019 preliminary results are:

- Total fund returns of 6.5%, 9.9%, 6.6% and 10.4% beat their benchmarks by 1.3%, 2.1%, 2% and 1.3% for the one-, three-, five- and ten-year periods respectively.
- For the ten-year period, the dollar value add from this excess performance is nearly \$4.8 billion.
- This performance placed ASRS in the top 5% of public pension plans for the ten-year period and in the top quartile for all other periods reported.
- Tactical positioning has added significant value to the portfolio over longer periods but was neutral in the most recent year, with positive contribution from the underweight equities posture but negative contribution from the short duration posture anticipating rate increases that did not occur.
- Equity returns beat their benchmarks in aggregate by 1.2%.
 - Private equity outperformed its benchmarks by 10.8% for the one-year period and 4.9% for the five-year period.
 - In public equity, internally managed portfolios and futures implementation added to excess performance.
 - Factor portfolios underperformed due to high performance in growth and mega-cap names, which are underweighted in the factor portfolios.
- Real estate portfolios outperformed for all time periods reported with strongest performance in the separate account portfolio which is the focus for future investment.
- The credit portfolio has added over \$1 billion in value over the last five years.

6. Presentation, Discussion, and Appropriate Action Regarding Appointment of Board Committee Officers and Membership

Mr. Jim Hillyard noted, for the record, appointment to the ASRS Board Committees effective immediately as follows:

Investment Committee (IC)

Chair: Michael Lofton
Vice-chair: Kevin McCarthy
Member: Clark Partridge

Operations, Audit, and Legislative Committee (OALC)

Chair: Clark Partridge
Vice-chair: Tom Manos
Member: Rene Guillen

Appeals Committee (AC)

Chair: Michael Miller
Vice-chair: Rene Guillen
Member: Tom Manos

7. Presentation, Discussion, and Appropriate Action Regarding Staff Recommended Updates to the ASRS Board Governance Policy Handbook

Mr. Paul Matson provided background regarding the ASRS Board Governance Policy Handbook, highlighting its importance as a living, key document in the governance of the ASRS. Mr. Matson noted:

- The handbook documents the ASRS governance model with very defined separation between decision-making and oversight, and
- Independent reporting to the Board by third parties is key for the effective implementation of the ASRS governance model.

The Handbook is continuously reviewed for potential changes, and ASRS staff documents suggested prudent changes to be presented to the Board at least every three years. The changes proposed at this time consist of minor verbiage changes. Mr. Matson highlighted two of these changes:

- Page 3 – “Conduct an actuarial experience investigation study every five years” was amended such that actuarial experience studies would be conducted *at least* every five years. Also within that sentence, in order to more accurately reflect experience study terminology, to remove the word “investigation”.
- Page 28 – Recommending that feedback from the Board be communicated to the Director in either verbal or written form, as traditionally it has been verbal. Also, adding that the Board Chair will be able to meet with the Director to present and discuss the Board’s evaluation of the Director’s performance.

Motion: Mr. Kevin McCarthy moved to accept the recommended revisions to the ASRS Board Governance Policy Handbook. Mr. Michael Miller seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved
Mr. Clark Partridge – approved
Mr. Rene Guillen – approved
Mr. Michael Lofton – excused
Mr. Tom Manos – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

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

Mr. Matson relayed the following information to the Trustees:

- The Funding Policy will be updated to incorporate the motion made by the Board today with respect to the actuarial audit.
- The new Assistant Director of Member Services, Mr. Jeremiah Scott, is introducing some new initiatives in the Member Services Division. Mr. Scott is in the beginning stages of meeting with employers in an effort to build engagement and communication, as well as to promote the educational opportunities offered by the ASRS.
- The ASRS plans to request a one-year extension for the ASRS to complete the Executive Cloud Migration Initiative. Staff feels that with a one-year extension, the process can be completed with significant cost savings while also optimizing effectiveness.
- The results of the 2019 State of Arizona Employee Engagement Survey were released in June. Scores vary within the relevant range of 0 to 10, and the ASRS had an engagement score of 9.5, which places the Agency in the category of an outstanding organization. Below are various engagement scores to provide context to that score:

| | |
|----------------------------------|------------|
| Average Organization: | 1.8 |
| State of Arizona as a Whole: | 2.7 |
| <i>Outstanding Organization:</i> | <i>9.0</i> |
| ASRS: | 9.5 |

Mr. Matson attributed much of this success to the engaged management team.

Mr. Jim Hillyard congratulated Mr. Matson and the management team for the excellent engagement numbers, noting that the ASRS is clearly a leader among state agencies.

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

a. Operations, Audit and Legislative Committee (OALC)

Mr. Jim Hillyard announced the next OALC meeting will be held on October 9, 2019.

b. Investment Committee (IC)

Mr. Clark Partridge announced the next regularly scheduled IC meeting is to be held on September 16, 2019.

c. Appeals Committee (AC)

Mr. Kevin McCarthy announced the next AC meeting is scheduled to be held on August 13, 2019.

10. Board Requests for Future Agenda Items

No requests were made.

11. Call to the Public

Mr. Joe Geusic addressed the Board and expressed his perspective on focusing on funded status.

12. The next regular ASRS Board meeting is scheduled for Friday, September 27 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board Room, Phoenix, Arizona.

Mr. Jim Hillyard noted the next Board meeting is scheduled for Friday, September 27, 2019 at 8:30 a.m.

13. Adjournment of the ASRS Board

Motion: Mr. Kevin McCarthy moved to adjourn the July 26, 2019 public meeting of the Board at 9:51 a.m. Mr. Michael Miller seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved
Mr. Clark Partridge – approved
Mr. Rene Guillen – approved
Mr. Michael Lofton – excused
Mr. Tom Manos – approved

Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

Respectfully Submitted by:

Joyce Williams
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM