

**MINUTES
PUBLIC MEETING
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, July 30, 2021
8:30 a.m.**

The Arizona State Retirement System (ASRS) Board of Trustees met telephonically, with some attending in-person, in the 10th Floor Board Room of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012.

Mr. René Guillen, Acting Chair of the ASRS Board, called the meeting to order at 8:31 a.m.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. René Guillen, Acting Chair
Ms. Diane Landis (via teleconference)
Mr. Michael Lofton (via teleconference)
Mr. Kevin McCarthy (via teleconference)
Mr. Michael Miller
Ms. Sara Pirzada
Ms. Ashley Ruiz (joined the meeting via teleconference at 8:32 a.m.)

Excused: Mr. Jim Mueller

One vacant position.

A quorum was present for the purpose of conducting business.

Ms. Joyce Williams, ASRS Board Administrator, provided all attendees with telephonic meeting guidelines.

Mr. Guillen welcomed Ms. Sarah Pirzada to the ASRS Board, letting her know that she can use any of the trustees as a resource if she has any questions.

2. Approval of the Minutes of the May 28, 2021 Public Meeting and Executive Session of the ASRS Board

Motion: Mr. Michael Miller moved to approve the minutes of the May 28, 2021 Public Meeting and Executive Session of the ASRS Board. Mr. Kevin McCarthy seconded the motion.

By a roll call vote of 7 in favor, 0 opposed, 0 abstentions, 1 excused, and 1 vacancy, the motion was approved. The Trustee votes were as follows:

Mr. René Guillen – approved
Ms. Diane Landis – approved
Mr. Michael Lofton – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved
Mr. Jim Mueller - excused
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – approved (*Ms. Ruiz joined the meeting at 8:32 a.m.*)

3. Presentation, Discussion, and Appropriate Action Regarding ASRS Budget-Related Topics, including:

- a. The ASRS Appropriated and Continuously Appropriated Budget and Spending Plans for Fiscal Year (FY) 2022.**
- b. The ASRS Appropriated and Continuously Appropriated Budget Request and Spending Plans for FY 2023.**

Mr. Paul Matson, Director, introduced Ms. Martha Rozen, ASRS Chief of Administrative Services. Ms. Rozen opened the presentation by thanking the Board for the opportunity of presenting the spending plans for FY 2022 and FY 2023 and the budget request for appropriated funds for FY 2023. She introduced Mr. Chris Gustafson, Program Manager for Budget and Procurement, who compiled most of the materials for this presentation; Ms. M. Harrison, former Budget Manager and currently with the Investment Management Division, who assisted in the preparation of the materials being presented; and Ms. Lupita Breland, Investment Operations Manager, who presented the materials relevant to the spending plans for the Investment Management Division. Ms. Rozen also took a moment to introduce Mr. Jeremy Gunderson, the new ASRS Budget Manager as of Monday, July 26, 2021.

Ms. Rozen proceeded with the presentation of the materials and explained the various attachments included in the materials before addressing the first action item: changes to the FY 2022 Spending Plan. Ms. Rozen reviewed the changes as follows:

- Adding resources to Technology Services Division for one year to work through a backlog of highly critical projects;
- Increases to the Investment Spending Plan due to the growth in assets under management;
- The addition of a column for anticipated costs for the self-insurance program for non-Medicare individuals.

Ms. Rozen gave the floor to Mr. Gustafson to present the Administrative Spending Plan for FY 2023 and budget request details. Mr. Gustafson stated that the ASRS is focused on managing budgets and implementing strategies that make the ASRS more cost-efficient, which has allowed the agency to reduce expenditures in the past. However, in FY 2022 and FY 2023, it is necessary to increase spending to enhance data security and technology. Mr. Gustafson stated that as more

information has been obtained for the cloud migration, the agency has more accurately identified the annual costs associated with the migration. Additionally, Mr. Gustafson addressed one of the agency's preferred service management software products for the ASRS intranet that is critical to the internal processes of the ASRS must also be migrated to the cloud. This migration incurs not only an initial cost but an ongoing annual cost as well. Closing out this portion of the presentation, Mr. Gustafson noted that the Production Support Team for the ASRS lacks sufficient developer resources to complete services requested to keep up with business needs; therefore, the ASRS is requesting funding for two FTE's to fill this need.

Mr. Gustafson turned to Ms. Breland to present the Investment Spending Plan. Ms. Breland noted that the costs to manage the investment program are authorized by the state as continuous appropriations. The investment-related funding requirements do not require formal requests to or approval from the Governor's Office or the Legislature. However, the prior year's actual investment-related expenses and estimated expenses for the coming years are reported to both entities as part of the annual ASRS budget request and submission process. Therefore, the ASRS wanted to allow the Board to review the administration and use of the appropriations for investment program purposes. As shown in attachment C, the most significant expense related to this program is management fees, which will slightly increase in FY 2023 over FY 2022 due to committing funds to private market assets. Ms. Breland noted that operational costs remain relatively steady.

Mr. Guillen took this time to congratulate Ms. Breland for recently celebrating twenty-five years with the ASRS and thanked her for her service and dedication to the agency. There were no questions from the Board, and Mr. Gustafson concluded the presentation.

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

- 1) The proposed updated administrative spending plan of \$32,787,700 for FY 2022 that includes the addition of resources for IT and data security enhancements with the understanding that there may ultimately be changes to the total appropriated budget amount due to legislative and executive adjustments and the updated continuously appropriated investment spending plan of \$133,036,600 for FY 2022 subject to revised management projections, and to include private markets performance incentives and other fees when identified and paid.

Ms. Sarah Pirzada seconded the motion.

By a roll call vote of 7 in favor, 0 opposed, 0 abstentions, 1 excused, and 1 vacancy, the motion was approved. The Trustee votes were as follows:

Mr. René Guillen – approved
Ms. Diane Landis – approved
Mr. Michael Lofton – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved
Mr. Jim Mueller - excused
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – approved

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

- 2) An appropriated budget request for FY 2023 in the amount of \$25,606,000, 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 roll call vote of 7 in favor, 0 opposed, 0 abstentions, 1 excused, and 1 vacancy, the motion was approved. The Trustee votes were as follows:

Mr. René Guillen – approved
Ms. Diane Landis – approved
Mr. Michael Lofton – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved
Mr. Jim Mueller - excused
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – approved

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

- 3) The proposed administrative spending plan of \$34,165,900 and continuously appropriated investment spending plan of \$137,450,000 for FY 2023 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 roll call vote of 7 in favor, 0 opposed, 0 abstentions, 1 excused, and 1 vacancy, the motion was approved. The Trustee votes were as follows:

Mr. René Guillen – approved
Ms. Diane Landis – approved
Mr. Michael Lofton – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved
Mr. Jim Mueller - excused
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – approved

4. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Program Update

Mr. Paul Matson introduced the new Chief Investment Officer (CIO), Mr. Michael Viteri, to the Trustees. After a brief introduction of the upcoming topics, Mr. Viteri gave the floor to Mr. Allan Martin, NEPC, who provided views on the current economic and market outlooks. Amid one of

the most challenging economic environments in recent history, Mr. Martin provided the Board with the following observations.

- Maintain a rebalancing discipline. The equity market surge is causing the equity percentage of the portfolio to rise, and staff doesn't want to have the highest equity exposure when we do have a correction.
- Private equity and private debt are likely to outperform public equities on a risk-adjusted basis if inflation returns.
- Continue to maintain a diversified discipline portfolio.
- Alpha counts. Be able to outperform in asset classes that may not be as efficiently priced. ASRS has added about 1% over policy fairly consistently over the long term.

Mr. Martin concluded that the ASRS portfolio is properly positioned and fulfills all of the above during this particularly challenging period.

Mr. Samer Ghaddar, Deputy CIO, presented the public and private equity house views. In public equities:

- Current valuations are approximately two standard deviations above the 20-year mean. These lofty valuations mean equity markets are susceptible to interest rate movements, the 10-year yield in particular.
- Equities are not cheap: the US market, in particular, trades at a premium across capitalizations compared to historical levels.
- Still constructive on the equity markets across regions and sub-asset classes as the recovery remains intact.
- See decelerating US GDP growth in the upcoming quarters. Decelerating growth will still positively affect equities; however, performance going forward will differ compared to an environment of accelerating growth in terms of sectors and underlying factors.
- Total public equity positioning:
 - 2% overweight in Public equity
 - Equal weight across geographies
 - In line with the benchmark index

In private equities:

Market conditions:

- Buyout Funds continue to have elevated levels of uncalled capital.
- The number of funds raising capital in the market is almost at a record high (quarterly basis).

Implications:

- Higher valuations across sectors and segments of the market. Higher excess capital to be deployed leads to higher deal multiples.
- Moreover, bidding for deals is competitive, pushing valuation multiples higher.
- In the first quarter of 2021, the final close reached an aggregate amount of ~\$270 billion.
- US-dedicated funds still dominate capital raising at ~ two-thirds of the total.
- Business confidence has been increasing, as seen in the pick-up of corporate strategies (M&A activity).

- Overall Implication for ASRS: The Private Equity team is very selective in making commitments and will keep the pacing model target for 2021 flexible.

Mr. John Doran, Fixed Income Portfolio Manager, presented house views on the Interest Rate Sensitive and Private Credit asset classes. Mr. Doran reviewed the following highlights.

Interest Rate Sensitive:

- As of June 30, we are underweight Interest Rate Sensitive Fixed Income with an allocation of 7.6% versus a 10.4% Interim SAA target.
- The Bloomberg Barclays U.S. Aggregate Bond Index, the benchmark for Interest Rate Sensitive Fixed Income, is now yielding only 1.5% vs. 2.3% at the beginning of 2020. The index yield has historically been a good indicator of long-term expected returns of the asset class.
- Staff does not expect attractive returns in the asset class going forward relative to the total fund's target return with this low yield.
- However, staff expects to maintain a meaningful investment in the asset class. This will serve as a source of liquidity to meet the total fund's needs and serve as a counter-balance to potential sell-offs in risky assets such as equities.

Credit:

- There are compelling investment opportunities to exceed the performance of the Credit asset class benchmark over time in Private Debt, Distressed Debt, and Other Credit. These opportunities are almost exclusively in private rather than public markets.
- Staff generally does not believe that public credit markets (such high yield bonds, leveraged loans, and asset-backed securities) offer attractive investment opportunities compared to the private markets. Public market opportunities will likely not meet the return of the Credit asset class benchmark over an extended, multi-year period.
- Moreover, in contrast to the private markets, the public credit markets do not provide investors with the opportunity for complete due diligence and bespoke tailoring of deal terms.

Mr. Doran also detailed the staff's allocation process for the Credit portfolio, comprised of Private Debt, Distressed Debt, and Other Credit.

Mr. Micheal Copeland, Private Markets Portfolio Manager, began his presentation by reviewing the staff's real estate philosophy.

- Demand-Driven Investing:
 - Real estate performance is strongly influenced by observable and durable demographic and economic trends.
 - Rental increases occur in situations with high demand and constraints on supply.
 - The risk of real estate is not having tenants.
- Invest through separate accounts:
 - Firms are expected to be vertically integrated with full-service capabilities (property construction, leasing, management, etc.) in their targeted property type(s).
 - ASRS will be the majority owner and will have significant control rights.
 - Ability to expand the relationship.
 - Every asset is underwritten to earn an 8% net return on a ten-year basis.

- Model allocation is meaningfully different from the NCREIF ODCE benchmark by property type and risk profile:
 - Overweight to where people live and underweight to where people shop and work.
 - Maintain an underweight of stabilized (core) assets.

Mr. Viteri introduced the new Investment Risk and Compliance Officer, Mr. Robert Butler, to the Board.

Mr. Allan Martin, Partner, NEPC, reviewed compliance with ASRS board goals, noting full or partial compliance except achieving a one-year total fund net return greater than the Strategic Asset Allocation Benchmark. Comparing first-quarter asset class performance to the benchmark showed that the Fund outperformed all benchmarks in the one- and three-year returns except in the equity asset class, where we've had some strategic changes. As of June 30, 2021, the Fund is valued at \$49 billion, and the fiscal year return is at 25%.

Ms. Lupita Breland, Investment Operations Manager, presented the compliance report.

- The Internally Managed Portfolios Pre-Trade Compliance System Review Summary included pre-trade compliance performed on all internally managed fixed income and equity portfolios for March 2021 – May 2021. No exceptions occurred during the period under review.
- The State Street Global Services Investment Compliance Program includes compliance reviews on all public markets portfolios and total fund level investments for February 2021 – April 2021. Ms. Breland noted that this would be the last report from State Street Global Services. Future reports will be from BNY Mellon.
 - Public Markets Investment Limits – State Street's review found a few findings resulting from index changes, corporate actions, and informational flags. All conclusions were researched and resolved to both State Street's and ASRS' satisfaction for all periods.
 - Total Fund Monthly Statutory Investment Limits – Total Fund investments passed the five mandated statutes on investment limits, as well as the Arizona Restricted Country Test for all periods.
- The Private Markets Investment Compliance Program includes reviews by two investment consultants for the ASRS.
 - RCLCO, Real Estate Separate Account Investment Compliance Review – RCLCO is currently working on the compliance reviews for the 2020 review period.
 - Meketa Investment Group, Commingled Funds, and Non-Real Estate Separate Accounts Investment Compliance Review – Meketa is currently working on the compliance reviews for the 2020 review period.

5. Presentation, Discussion, and Appropriate Action Regarding the ASRS Experience Study

Mr. Matson provided the Board with a summary of the purpose of, and outcomes from, conducting both experience studies and annual valuations. Mr. Matson then introduced the ASRS's external actuarial firm, Gabriel, Roeder, Smith & Co. (GRS). Mr. Paul Wood then presented GRS's findings from the experience study.

Preliminary Experience Study Findings – Summary

- Inflation Rate – Recommend maintaining the 2.3% assumption
- Investment Return Assumption – Recommend lowering the investment return assumption to 7%, which is closer to the expected return in GRS' independent capital market analysis
- PBI Assumption – Recommend maintaining the 0.30% assumption
- Individual Salary Increase – Recommend increasing the wage inflation from 2.7% to 2.9%, as well as some increases in the step rates
- Payroll growth rate (Amortization payment growth rate) – Recommend increasing this rate to 2.7%
- Post-retirement mortality - Recommend no change to the ASRS specific base table but update to the newest ultimate mortality projection scale
- Pre-retirement mortality and disabled mortality – Recommend updating to the Pub-2010 tables
- Demographic Assumptions - Recommend changes to rates to better reflect recent experience
- Form of Payment Assumption for Vested Deferred – Recommend recognizing the fact that not all members choose the most valuable option
- Health Insurance Supplement – Recommend adjusting participation assumption
- Form of Payment Load – Recommend removing the small load of 0.174%

Mr. Wood described the actuarial impact projections produced by a lower investment return assumption to the Plan valuations and the Long-term Disability (LTD) valuations.

Next, Mr. Wood described a possible phase-in approach to split the impact of the experience study into a set number of “layers.” Each layer would be incorporated into the contribution rate over the set number of years. The full impact of the experience study will be recognized in 25 years per the funding policy. This phase-in approach provides short-term contribution relief while adopting a more conservative 7% assumption.

Mr. Wood briefly described negative amortization and some strategies to address it. There was additional commentary from Mr. Matson and members of the Board.

Motion: Mr. René Guillen moved to approve the adoption of the experience study and recommendations, and the resulting changes in assumptions as presented by GRS on Page 180 of 341 of the Board Packet and Titled “Decisions Required - Summary of Recommended Assumption Changes,” and to recognize these changes immediately in the funded status and expected costs for the pension plan, the health insurance premium benefits program, and the long-term disability program, and to also recognize these changes immediately in the amortization of the accrued liability for the health insurance premium benefits program and the long-term disability program, and to phase-in the amortization of the accrued liability for the pension plan over three years, and to move from a 25-year to a 20-year amortization schedule beginning with the June 30, 2022 valuation.

Mr. Michael Miller seconded the motion.

By a roll call vote of 7 in favor, 0 opposed, 0 abstentions, 1 excused, and 1 vacancy, the motion was approved. The Trustee votes were as follows:

Mr. René Guillen – approved
Ms. Diane Landis – approved
Mr. Michael Lofton – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved
Mr. Jim Mueller - excused
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – approved

Mr. Guillen suggested that the Board consider ways to communicate the value and the benefit of ASRS membership.

7. Presentation, Discussion, and Appropriate Action Regarding Staff Recommended Updates to the ASRS Board Governance Policy Handbook (*this agenda item was reordered*)

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

Mr. Kevin McCarthy seconded the motion.

By a roll call vote of 7 in favor, 0 opposed, 0 abstentions, 1 excused, and 1 vacancy, the motion was approved. The Trustee votes were as follows:

Mr. René Guillen – approved
Ms. Diane Landis – approved
Mr. Michael Lofton – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved
Mr. Jim Mueller - excused
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – approved

6. Presentation, Discussion, and Appropriate Action Regarding the ASRS Health Insurance Plan and Self-Funding Initiative (*original order of the agenda resumed*)

Mr. Russ Levine, Health and Disability Plan Administrator, presented an overview of the ASRS health insurance program and shared highlights from the current self-funding initiative. Joining Mr. Levine telephonically, Mr. Richard Ward of the Segal Group was available to answer the Board's questions. Mr. Ward is the Segal Group's West Region Public Sector Director and the Lead Actuary assisting the ASRS health program. Mr. Levine began the presentation with a description of the two distinct components of the ASRS Health Insurance Program. Next, he listed the group dental and medical plans offered by the ASRS. Mr. Levine also described the ASRS group medical and prescription drug coverage options for the Medicare-eligible group, encompassing nearly 90% of all ASRS medical plan participants. For the 2022 plan year, benefit

structures for all plans remain unchanged, and member satisfaction and feedback regarding these plans remains very high. Staff is pleased with the monthly rate compression they have achieved and extended to retirees across the four years presented. During this period, there was over a 50% reduction in the total premium before applying any retrospective rate agreement funds and monthly premium benefit subsidies. During this same period, other health and wellness programs offered under the plan were expanded. Mr. Levine also reviewed the ASRS group medical and prescription drug coverage options for the Non-Medicare group.

Other topics addressed by Mr. Levine included:

- The annual one-way “Retrospective Rate Agreement” (RRA) requirement that aggregate revenues above a certain expense threshold be refunded to the ASRS.
- The plan to transition the Non-Medicare retiree medical and pharmacy program from a fully insured to a self-insured model for plan year 2022.
- The governance, management, and oversight structure for the health insurance program includes engaged external independent actuaries specializing in the healthcare industry.
- Non-Medicare premium comparisons and initial year projections for 2022, including modeling assumptions and methodology.

Mr. Guillen thanked the staff for the thoughtful effort in identifying ways of lowering medical insurance costs for ASRS retirees, and Mr. Matson confirmed that this presentation was to inform the Board about the status of such a significant undertaking by staff to keep medical costs as low as possible.

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

Mr. Matson had no additional comments.

9. Notification of Upcoming Board Elections to Occur at the September 24, 2021 Board Meeting

Mr. Guillen announced the upcoming Board elections to occur at the September 24, 2021 Board Meeting.

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

a. Operations, Audit and Legislative Committee (OALC)

Mr. René Guillen announced that the next OALC meeting is to be held on October 13, 2021.

b. Investment Committee (IC)

Mr. Michael Lofton announced that the next IC meeting is to be held on September 20, 2021.

c. Board Appeals Committee (AC)

Mr. Michael Miller announced that the next Board AC meeting is scheduled to be held on October 12, 2021.

11. Board Requests for Future Agenda Items

No requests were made.

12. Call to the Public

No requests were made.

13. The next regular ASRS Board meeting is scheduled for Friday, September 24, 2021, at 8:30 a.m.

Mr. René Guillen noted that the next Board meeting is scheduled for Friday, September 24, 2021, at 8:30 a.m.

14. Adjournment of the ASRS Board

Mr. René Guillen adjourned the July 30, 2021, ASRS Board meeting at 11:41 a.m.

Respectfully Submitted by:

Joyce Williams
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM