

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

**Friday, July 31, 2020
8:30 a.m.**

The Arizona State Retirement System (ASRS) Board of Trustees met telephonically.

Mr. Jim Hillyard, 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. Jim Hillyard, Chair
Mr. Clark Partridge, Vice-chair
Mr. Rene Guillen
Mr. Michael Lofton
Mr. Tom Manos
Mr. Kevin McCarthy
Mr. Michael Miller

Two vacant positions.

A quorum was present for the purpose of conducting business.

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

2. Approval of the Minutes of the May 29, 2020 Public Meeting of the ASRS Board

Motion: Mr. Clark Partridge moved to approve the minutes of the May 29, 2020 Public Meeting of the ASRS Board. Mr. Tom Manos seconded the motion.

By a roll call vote of 7 in favor, 0 opposed, 0 abstentions, 0 excused, and 0 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 – approved
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. The ASRS Appropriated and Continuously Appropriated Budget and Spending Plans for Fiscal Year (FY) 2021.**
 - b. The ASRS Appropriated and Continuously Appropriated Budget Request and Spending Plans for FY 2022.**

Mr. Anthony Guarino introduced Ms. Martha Rozen, Chief of Administrative Services, Mr. Chris Gustafson, Budget and Procurement Manager, and Ms. Kerry White, Assistant Chief Investment Officer who led the discussion and presented the proposed spending plans.

Ms. Rozen opened the discussion by introducing two new analysts who have been assigned to the ASRS budget. The Governor's Office of Strategic Planning and Budget has assigned Mr. Blake Dodd and the Joint Legislative Budget Committee has assigned Ms. Molly Murphy. Ms. Rozen also recognized Ms. M. Harrison, Budget Manager, who provided a great deal of assistance and input with preparing the materials. Ms. Rozen added that although Mr. Gustafson and Ms. White will be presenting the materials, Ms. Harrison and Mr. Dave King, Assistant Director, Technology Services Division, would be available to answer any questions the Board may have regarding the proposal. Ms. Rozen turned the presentation over to Mr. Gustafson.

Mr. Gustafson reviewed the budget recommendation with the Board and highlighted the following:

- The budget includes key performance indicators to reduce the base administration budget by 3% from FY 2017 to FY 2020. The agency has not only met that goal but has exceeded it and reduced its base administrative spending by 4.68%. Mr. Gustafson referred the Trustees to a detailed reference chart on Page 2 of the attached OALC memo.
- Over the course of the next several fiscal years, the ASRS continues to focus on managing budgets and implementing strategies designed to improve operational effectiveness and make the ASRS more cost effective.
- FY 2021 and FY 2022, administrative spending plans support system and technology modernizations, the framework of the ASRS business model, with an emphasis on security risk mitigation and re-engineering of processes. These investments in technology will help the ASRS avoid future costs associated with inefficient processes. Mr. Gustafson referred the Trustees to Attachments A and B, which highlight the FY21 Spending Plan and the current lists of projects the ASRS is working on.
- FY 2022 the ASRS must complete its required migration to the cloud, upgrade an essential system and implement a critical technology solution to further safeguard data. This will require an increase in the budget request of the ASRS' base operating appropriations. Technology projects are outlined in Attachment B. Attachments D and E show the budget request and the projected budget for FY 2022. Mr. Gustafson provided the following details:
 - In 2019 the Arizona Department of Administration implemented a Cloud First policy which necessitates the ASRS to migrate its infrastructure for data, systems, servers, and processes from its current physical data center to a cloud environment. With this will come a one-time Cloud Migration transition cost for external consulting resources, followed by ongoing annual Cloud costs for Cloud services.
 - The current version of FileNet is no longer supported and the ASRS will need external resources to successfully configure and implement an upgrade necessary to eliminate any disruption in service to this document management system.

- Data subsetting, a software product compatible with core applications to allow teams to utilize only the relevant section of the ASRS' database rather than the full system will enable the ASRS to work on improvements without affecting the entire database or creating business disruption, along with enhancing data security. Mr. Gustafson referred the Trustees to Page 4 of the attached OALC memo, which contains a chart detailing the structure of the two-year allocation, as well as a more detailed description of the costs.

Mr. Gustafson responded to questions from the Board and turned the presentation over to Ms. Kerry White, Assistant Chief Investment Officer. Ms. White referred the Trustees to Attachment C for her review of the Investment Spending Plan as follows:

- FY 2021 and FY 2022 are relatively the same; with very little differences in the projections.
- The bulk of the requested budget is for management fees in public and private markets.
- Changes to the spending plan may occur from additional automation of workflow, mandate changes to the portfolio, regulatory or legislative changes or management decisions.
- Finalization of contractual changes currently in progress for additional automation of workflow, which will come with additional costs that are not reflected in the materials presented, will be updated as the information becomes available.

For the record, a copy of the detailed budget proposal is attached to these minutes.

Motion: Mr. Clark Partridge moved to accept the budget as proposed and for it to be forwarded for consideration to the budget offices and the legislature. Mr. Rene Guillen seconded the motion.

By a roll call vote of 7 in favor, 0 opposed, 0 abstentions, and 0 excused, 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 – approved
Mr. Tom Manos – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

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

Mr. Karl Polen, Chief Investment Officer, reported that total fund year-to-date returns through June 30, 2020 are approximately 1%, and assets are at approximately \$40.5 billion.

Mr. Polen's report to the Board covered the following three topics:

- Current status of the economy and economic outlook and implications for investments.
The Fund is remaining neutrally positioned as of 7/20/2020. Mr. Polen reviewed the differences between the stock market and the economy and how the financial markets' responses to the worldwide pandemic differed from other times of financial distress.

- Annual update to the Board of internal implementation planning process and how they relate to Board-established goals.

Mr. Polen reviewed a summary of all internal implementation plans for the Board. He noted that these plans illustrate a three- to five-year plan of action, compared to the Strategic Asset Allocation (SAA), which represents a twenty- to thirty-year plan of action for the Fund. These implementation plans are stable and are reviewed annually, allowing for adjustments to be made when necessary. Significant changes were made to the Equities Implementation Plan, and few changes were made to the Real Estate Implementation Plan.

Mr. Polen presented preliminary results for periods ended June 30, 2020, summarized as follows:

- Total fund returns of .8%, 5.5%, 6.1% and 8.9% exceeded benchmark returns by .7%, 1.2%, 1.6% and 1.2% for the one-, three-, five-, and ten-year periods, respectively.
- Comparisons to the public fund universe for the June 30 period were not available, but that analysis for periods ended March 31 showed ASRS to be in the top decile of public plans for all of the one-, three-, five-, and ten-year periods.

Mr. Polen answered questions and provided background on this discussion item.

5. Update on the Operational, Investment, and Program Statuses of the ASRS as a result of the Current Pandemic Situation

Mr. Paul Matson, Director, gave an update to the Board of the operational, investment, and program statuses of the ASRS.

- Operational status, internal (staffing) and external (customer service).
 - Mr. Matson described the timeline of ASRS staff working from home. In the first week of the pandemic, staff working onsite at 3300 N. Central Ave. was at about 25%. That percentage went to 12% over the following few weeks. As COVID-19 results increased, staff and management reevaluated the situation and currently, about 7% of the ASRS staff is working in the office. That is close to the minimum onsite staffing needed to maintain nearly 100% functionality, and the physical risk for those who are onsite is greatly reduced because so many are working from home.
 - Mr. Matson described the research project currently underway to determine what the future of the ASRS' workforce will look like. Optimistically, the ASRS will be operating in a post-pandemic environment by the first quarter of 2021, but in any case, the workforce will continue to be very fluid and flexible.
 - In response to fewer staff members on site, Mr. Matson also spoke about the distinct possibility of the ASRS potentially vacating one floor in the 3300 N. Central Avenue building. This would free space that will be available to lease when the local demand for office space increases.
 - Customer service levels have continued to exceed expectations over the past few months. Mr. Matson referred to the Board materials for Agenda Item #5 for detailed work-from-home summary reports and again complimented the Member Services staff, and related areas, on continuing to perform beyond expectations.
- Investments and actuarial status of liquidity and return volatility.

- Mr. Matson referred to the Investment Positioning Summary Reports in the Board materials and reminded the Board of the three main goals being managed by the IMD: portfolio liquidity, ability to benefit from opportunities as they arise, and portfolio rebalancing as needed.
 - Mr. Matson referred to the Cash Flow Aggregate Report included in the Board materials and highlighted the relevant characteristics of internal and external cash flow during the pandemic. This report helps illustrate the Fund's liquidity as well as any external cash flow stress which might result from increased depletion of pension funds due to increased withdrawals or increased member retirements. The report shows an increase over the previous year in external cash received from contributions, approximately \$158 million. This increase can be attributed to salary increases resulting in increased contributions, employment increases, and a small increase in the contribution rate.
- Payments out of the Fund mainly consist of retirement and disability payments and refunds. Approximately \$104 million more has been paid out this year compared to last year, so in spite of the pandemic, negative cash flow was improved by about \$54 million.
- Impact on contribution rates and funded status.
 - Contribution rates: At the beginning of 2020, pre-pandemic projections on contribution rates would have shown a peak in about 2022 at approximately 12.22%. Now, impacted by the effects of the pandemic, they are projected to peak in about 2034 at approx. 13%, increasing by about .8%.
 - Funded status: Originally, the actuarial funded status as of June 30, 2019 was 72.3% and the June 30, 2020 projected rate was 73.2%, or increasing by .9%. Currently, the funded status is projected to increase by about .3%. At this point in time, a more reasonable projected rate estimate would be 72.6%.
- Program results for pensions (addressed above), health insurance, and long-term disability (LTD).
 - Health insurance: Approximately every two weeks, the ASRS receives data related to the pandemic from our health-care provider. Five elements are reported, determining Medicare and non-Medicare categories of tests, infection rates, medical services received by ASRS retirees, access nodes such as in-office visits or telemedicine, and costs. With respect to infection rates, we monitor confirmed COVID-19, probable, and possible cases, categorized by Medicare and non-Medicare.
 - In relation to the expectation that health insurance costs would have been likely to increase during this pandemic season, Mr. Matson explained that expenditure patterns have actually decreased because many retirees are not seeing their doctors as often as in previous years and are postponing elective surgeries. This reduction in health care costs will impact the Retroactive Rate Agreement that the ASRS has in place and will allow that cost savings to offset future health care premiums. The impact on health insurance, from a fiscal perspective, is slightly positive, and not significantly negative, as some observers might have assumed.
 - LTD: LTD is currently at approximately 74.8% funded status, which is a dramatic increase from 17.6% in 1996. Although the impact of falling contribution rates won't be evident in LTD for another year or two, Mr. Matson reviewed some statistics

which indicate that there should eventually be a positive impact on LTD funded status and a lowering impact on contribution rates going forward.

- The number of individuals opening new claims in 2018 was 574, in 2019 it was 539, and for the year that just ended on June 30, 2020, it was 527.
- Over the last 20 years, LTD program participation went from approximately 2.2% of the ASRS active workforce to about 1.5%.
- From a cash flow perspective, in 2018 our net LTD payments were \$56.7 million, compared to payments for the year ending June 30, 2020 of \$51.4 million.

Chairman Hillyard again commended Mr. Matson and the whole ASRS team for their ability to continue to serve the ASRS members and employers during the pandemic.

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

Mr. Jim Hillyard thanked the Board members for their committee work in the past year and reaffirmed, for the record, continuing appointments to the ASRS Board Committees effective immediately as follows:

Appeals Committee (AC)

Chair: Michael Miller

Vice-chair: Rene Guillen

Member: Tom Manos

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

7. Presentation and Discussion Regarding Fiduciary Education

Ms. Cassie Adams, Assistant Attorney General, provided brief presentations regarding Trustee fiduciary responsibility and Arizona's Open Meeting Law. Ms. Adams also reviewed the informal opinion issued by the State of Arizona's Office of the Attorney General addressing concerns relating to Arizona's Open Meeting Law and COVID-19.

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

Mr. Matson had no further comments for the Trustees.

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

a. Operations, Audit and Legislative Committee (OALC)

Mr. Clark Partridge announced the next OALC meeting is to be held on October 14, 2020. Mr. Partridge also commended the staff for their work reviewing operations and gave them his appreciation for their hard work and preparation for their meetings, as well as in the day-to-day operations of the agency.

b. Investment Committee (IC)

Mr. Lofton announced the next IC meeting is to be held on September 21, 2020.

c. Appeals Committee (AC)

Mr. Mike Miller inadvertently announced the next AC meeting is to be held on September 8, 2020, however, it should be noted for the record the correct date is October 13, 2020.

10. Board Requests for Future Agenda Items

No requests were made.

11. Call to the Public

No members of the public requested to speak.

12. Adjournment of the ASRS Board

Motion: Mr. Michael Lofton moved to adjourn the ASRS Board meeting. Mr. Michael Miller seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 0 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 – approved
Mr. Tom Manos – approved
Mr. Kevin McCarthy – approved
Mr. Michael Miller – approved

Mr. Jim Hillyard adjourned the July 31, 2020 public meeting of the Board at 10:46 a.m.

Respectfully Submitted by:

Joyce Williams
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM