

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

**Friday, September 24, 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 8:30 a.m.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. René Guillen, Acting Chair
Ms. Diane Landis
Mr. Michael Lofton
Mr. Kevin McCarthy (via teleconference)
Mr. Michael Miller
Mr. Jim Mueller (via teleconference)
Ms. Sara Pirzada

Excused: Ms. Ashley Ruiz

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.

2. Approval of the Minutes of the July 30, 2021 Public Meeting of the ASRS Board

Motion: Mr. Michael Miller moved to approve the minutes of the July 30, 2021 Public Meeting of the ASRS Board. Mr. Michael Lofton seconded the motion.

Mr. Jim Mueller abstained as he was not in attendance at the July 30, 2021, meeting.

By a roll call vote of 6 in favor, 0 opposed, 1 abstention, 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 - abstained
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – excused

3. Presentation, Discussion, and Appropriate Action Regarding the ASRS 2022 Proposed Regulatory Agenda and Update on ASRS Rulemaking Activities

Ms. Jessica Thomas, Government Relations Officer and Rules Writer, addressed the Board. Ms. Thomas said that all the rulemakings from the 2020 agenda have been completed, with the exception of the Non-Participating Employer Rulemaking and the Alternate Contribution Rate rulemaking, which staff determined were no longer necessary. Ms. Thomas also stated that staff has completed drafting the language for all the rulemakings listed on the 2021 regulatory agenda and will present the language to the OALC in October. Additionally, staff has completed drafting language for two rulemakings that were not listed on the regulatory agenda: health insurance appeals rules and a rulemaking related to the 5YRR approved by the Governor’s Regulatory Review Council in May. Staff will be presenting those rulemakings to the OALC in October, as well.

Motion: Mr. Michael Miller moved to approve the 2022 Regulatory Agenda as presented. 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 - approved
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – excused

4. Presentation, Discussion, and Appropriate Action Regarding Application of the ASRS Assumed Actuarial Investment Earnings Rate to Applicable Rules

Mr. Paul Matson, Director, briefly introduced this topic to the Trustees, with a reminder that the assumed rate of return for actuarial calculations was changed at the last Board meeting from 7.5% to 7.0%, effective June 30, 2021.

Ms. Jessica Thomas then briefly reviewed how the Assumed Actuarial Earnings Rate is used in rules, noting that this change affects approximately 13 rules that use this rate for purposes of providing and collecting interest. Incorporating the change in the Assumed Actuarial Earnings

Rate will add an additional line to R2-8-118, which illustrates the application of interest from inception of the ASRS Plan through the present.

Ms. Thomas and Mr. Matson fielded questions and comments from the Board.

Motion: Mr. Michael Miller moved to approve the addition of a new Assumed Actuarial Earnings Rate to the table in 2 A.A.C. 8, R2-8-118 to match the new assumed rate of return of 7.0% and to be effective July 1, 2022. Ms. Diane Landis seconded the motion.

By a roll call vote of 7 in favor, 0 opposed, 0 abstentions, 2 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 – excused
Mr. Michael Miller – approved
Mr. Jim Mueller - approved
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – excused

Note: Mr. Kevin McCarthy lost connection with the meeting during this agenda item and did not vote on this motion. He rejoined the meeting at approximately 8:56 a.m.

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

Mr. Allan Martin, NEPC, presented a market environment overview for the period ending August 31, 2021.

Among his observations:

- Despite the Federal Reserve's (the Fed's) growing concerns about inflation, defaults in China, since the close of Q1 2021, the Standard & Poor's 500 (S&P) was up roughly 3 ½%. Current factors impacting the current economic environment include robust economic growth driven by unprecedented fiscal and monetary stimulus and pent-up demand from the lifting of COVID restrictions. This outlook is tempered by the unknown success rate of vaccinations and the rise of the Delta variant. Additionally, concerns about inflation.
- At the end of Q2 2020, the Gross Domestic Product (GDP) rose by 6.6%. Retail sales and corporate profits are up, and the unemployment rate is down.
- S&P valuations increased in Q2 to 37.92 from 36.77 in Q1 and remained higher than the 10-year average of 27.2.
- The Fed's balance sheet continues to grow in the wake of the pandemic as they remain committed to continuing stimulative action as need to support the US economy.
- If inflation and interest rates continue to rise, we will see declines in Price-to-Equity ratios and, ultimately, in equity values.

Mr. Samer Ghaddar, Deputy Chief Investment Officer (CIO), presented 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 as of September 16, 2021
 - 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.

In 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.

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.

Real Estate:

- 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.

Next, Mr. Ghaddar presented the Performance Report to the Trustees. Mr. Ghaddar reported that the Fund's total asset value is estimated through June 30, 2021, at just under \$50 billion, and fiscal year-to-date (FYTD) total fund returns are approximately 25.08% against the benchmark of 26.83%.

Highlights of ASRS performance for the fiscal year June 30, 2020, through June 30, 2021, are as follows:

- For US Equity, the ending market value on June 30, 2021, is approximately \$12.47 billion. Total equity returns for the FYTD of 44.71% outperformed the benchmark by 0.27%. Staff feels that this improvement in performance directly reflects the restructuring of the public equity portfolio in 2020.
- For International Equity, the ending market value on June 30, 2021, is approximately \$9.1 billion and had FYTD returns of 37.11%.
- For Fixed Income (Interest Rate Sensitive), the ending market value on June 30, 2021 is approximately \$3.7 billion, is slightly underweight, and underperformed by 0.04%.
- The total credit portfolio for the three months ending March 31, 2021, shows a valuation of just over \$10 billion with FYTD returns of about 13.84%.
- For Private Equity, the ending market value on June 30, 2021, is approximately \$5.2 billion. Private equity FYTD performance is 39.19%.

- The Real Estate valuation is at approximately \$7.8 billion, and fiscal year-to-date performance is 8.45%, exceeding its benchmark by 6.97%.

Mr. Ghaddar fielded questions and comments from the Trustees.

Mr. Matson introduced the new Investment Risk and Compliance Officer for the ASRS, Mr. Robert Butler. Mr. Matson briefly explained that this new position was created as a separate reporting function for compliance and risk analysis, which had previously been handled by members of the Investment Management Division (IMD). His role is to work closely with the Chief Investment Officer, the Investment Operations Manager, and the Director (to whom he will directly report) to monitor compliance and to analyze and report on Plan risk. Mr. Butler briefly provided the Board with more detail about his experience and background. Mr. Butler provided the Board with the following explanations.

- Correlation report of the major asset classes. This report illustrates the measure of diversification across different asset classes.
- Asset class risk contribution. Although Public and Private Equities account for 54% of market value, equity exposure accounts for more than 75% of the overall portfolio risk.
- Stress test scenarios. This illustrates how the portfolio, as of June 30, 2021, would have performed in past market events. In the future, there will be an illustration of how long it would take the portfolio to recover from these market shocks, as well as a more detailed look at how decisions made at the portfolio level most impacted performance during market corrections. This will help in positioning the portfolio during future challenging market environments.

Ms. Pirzada requested a future discussion about the impacts of cybersecurity on the portfolio. Mr. Matson briefly described some aspects of the Agency's ongoing, dual focus on operational and financial cybersecurity assessments.

The Board engaged in additional questions and comments with Mr. Butler and Mr. Matson.

Mr. Martin returned to review 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 25.1%.

6. Presentation, Discussion, and Appropriate Action Regarding a Potential ASRS Pension Contribution Rate Pre-Funding Program (*this agenda item was reordered*)

Mr. Matson introduced the Board to the concept of a potential program for employers to prefund future pension contributions. Highlights of Mr. Matson's presentation included:

- Prefunding Concept
 - The program would be optional for employers
 - Employers would be able to prepay their future employer (not employee) pension contributions (not HBS/LTD)
 - ASRS would invest all prepaid contributions
 - Employers would be credited with an investment earning on prepaid balances
 - Employers would determine when to utilize their prepaid contributions

- Employers would determine the length of time (referred to as the amortization period) over which to utilize their prepaid contributions
 - Background: why this program might make sense at this time
 - The current financial economic environment has resulted in available employer cash balances and low-interest funding rate options.
 - Employer interest
 - Potential Advantages
 - Utilization of employer cash balances toward higher “interest” pension liabilities (accrue an investment return rather than accrue a low short term interest rate) for the specific participating employer: Employer Advantage
 - Offset required future contributions for the specific participating employers: Employer Advantage
 - Offset employers “pension” balance sheet liability (Net Pension Liability) reflecting the unfunded actuarial accrued liabilities (UAALs) for the specific participating employers: Employer Advantage
 - Increase overall funded status: State and ASRS Advantage
 - ASRS rates of return exceeding expectations: Employer, Employee, ASRS Advantage
 - Potential Disadvantages
 - Possible better options for employer funds (employer decision): Employer Disadvantage.
 - ASRS rates of return not meeting expectations: ASRS Disadvantage
 - ASRS and actuarial systems development (modest effort): ASRS Disadvantage
- Note: ASRS disadvantages flow through as employer and employee disadvantages
- Key Determinations and Decisions
 - Return Assumption (to accrue to balances)
 - Amortization Periods (possibly 10, 20 & 30 years)
 - Prepayment Limitations:
 - Size of Prepayments (possibly \$100,000 - \$1 billion)
 - Constraint on Prepayments (possibly when ASRS or employer is 100% funded)
 - Required Balance Utilization (possibly when ASRS or employer is 100% funded)
 - Effective Dates for:
 - Program Inception
 - Amortization Inception

Mr. Matson responded to questions and comments from the Board.

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

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 June 1 – September 16, 2021. No exceptions occurred during the period under review.
- The Custody Bank Investment Compliance Program includes compliance reviews on all public markets portfolios and total fund level investments for May 1 – September 16, 2021.

- Public Markets Investment Limits – The ASRS custody bank’s review found a few findings resulting from index changes, corporate actions, and informational flags. All findings were researched and resolved to both the custody bank’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.

7. Presentation, Discussion, and Appropriate Action Regarding Board Elections of Chair and Vice Chair (*original order of the agenda resumed*)

Motion: Mr. René Guillen moved to nominate Mr. Michael Miller as the ASRS Board Vice-chair. Mr. Michael Lofton 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 - approved
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – excused

Motion: Mr. Kevin McCarthy moved to nominate Mr. René Guillen as the ASRS Board Chair. 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 - approved
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – excused

Mr. Matson clarified that the Chair and Vice-chair serve their terms for the fiscal year. Mr. Matson

also clarified that the members of the Board Committees would be appointed by the Chair and are typically announced at a Board meeting.

8. Presentation, Discussion, and Appropriate Action Regarding the Calendar Year 2022 Board Meeting Schedule

Mr. Paul Matson presented the proposed 2022 Board meeting calendar to the Trustees, noting the similarity to the Board meeting calendar of 2021, with meetings beginning in January, occurring on the last Friday of every other month except November. Mr. Jim Mueller informed the Board that his schedule would conflict with the proposed meeting dates in January and July. Mr. Guillen suggested that the proposed calendar be approved today, and he will work with the Trustees and staff to determine alternate dates for those months.

Motion: Mr. Michael Miller moved to approve the recommended dates for the Board meeting schedule as presented for 2022. Mr. Michael Lofton 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 - approved
Ms. Sarah Pirzada - approved
Ms. Ashley Ruiz – excused

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

Mr. Matson had no additional remarks.

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 November 8, 2021.

c. Board Appeals Committee (AC)

Mr. Michael Miller announced that the next Board AC meeting is scheduled to be held on December 14, 2021.

11. Board Requests for Future Agenda Items

No requests were made.

12. Call to the Public

Mr. Steve Ramos, AEA-Retired, commented on Agenda Item #6, the Potential ASRS Pension Contribution Rate Pre-Funding Program. Mr. Ramos said that he thinks this is a great idea and that AEA and AEA-Retired would like to be included in upcoming discussions if this plan moves forward. Mr. Ramos asked if this program would impact the calculation of a future PBI. Mr. Ramos had no additional comments, so Mr. Guillen closed Agenda Item #12, Call to the Public, and reopened Agenda Item #6, the Potential ASRS Pension Contribution Rate Pre-Funding Program, allowing Mr. Matson to respond to Mr. Ramos' question.

6. Presentation, Discussion, and Appropriate Action Regarding a Potential ASRS Pension Contribution Rate Pre-Funding Program (this agenda item was reopened)

Mr. Matson responded to Mr. Ramos' question, saying that it would not affect the PBI. It's not more likely or less likely to cause a PBI, nor to impact the magnitude of a PBI. It might impact future contribution rates depending upon rates of return. The PBI is a function of an actuarial rate of return, and not of a funded status. Mr. Paul Wood from Gabriel, Roeder, Smith, and Company concurred with Mr. Matson. In addition, it was noted that if the ASRS' funded status rose significantly and contribution rates began to fall, that could enable members to contact legislators and say that it might be time to rethink how a potential PBI might be paid.

13. The next regular ASRS Board meeting is scheduled for Friday, November 12, 2021, at 8:30 a.m. (original order of the agenda resumed)

Mr. René Guillen noted that the next Board meeting is scheduled for Friday, November 12, 2021, at 8:30 a.m.

14. Adjournment of the ASRS Board

Mr. René Guillen adjourned the July 30, 2021, ASRS Board meeting at 11:18 a.m.

Respectfully Submitted by:

Joyce Williams
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM