



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
7660 EAST BROADWAY BOULEVARD • SUITE 108 • TUCSON, AZ 85710-3776 • PHONE (520) 239-3100
TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1 (800) 621-3778
EMAIL ADDRESS: ASKMAC@AZASRS.GOV • WEB ADDRESS: WWW.AZASRS.GOV

Paul Matson
Director

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

Friday, February 27, 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
Mr. Tom Manos
Mr. Tom Connelly
Professor Dennis Hoffman
Dr. Richard Jacob

A quorum was present for the purpose of conducting business.

2. Approval of the Minutes of the January 30, 2015 Public Meeting and Executive Sessions of the ASRS Board

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

By a vote of 6 in favor, 0 opposed, 0 abstentions, 0 excused, and 3 vacancies, the motion was approved.

Motion: Dr. Richard Jacob moved to approve the Minutes of the January 30, 2015 Executive Sessions of the ASRS Board. Prof. Dennis Hoffman seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 0 excused, and 3 vacancies, the motion was approved.

3. Presentation Regarding the Showcase in Excellence Awards from the Southwest Alliance for Excellence (SWAE) for Online Statements and Online Refunds

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, announced that the ASRS received two awards in late 2014 from the Southwest Alliance for Excellence (SWAE) for Online Statements and Online Refunds. Mr. Guarino shared that the SWAE is a non-profit corporation whose mission is to advance continuous improvement in excellence. With the implementation of the Online Statements and Online Refunds there was improved productivity and money savings without diminishing member satisfaction or service. The ASRS received the SWAE Awards for its innovative and cutting edge approach to public service.

The following staff were recognized and presented the award for the online statements: Dave King, Sara Orozco, Dave Cannella, and Valerie Burkett.

The following staff were also recognized and presented the award for online refunds: Sarah Korish, Brandon Heathcotte, and Sara Orozco.

4. Presentation, Discussion, and Appropriate Action Regarding 2015 ASRS Legislative Initiatives and Legislative Update

Mr. Nicholas Ponder, Government Relations Officer, addressed the Board regarding the 2015 Legislative Session and the ASRS Legislative initiatives. Mr. Ponder presented the Bill Tracker, which summarizes ASRS 2015 legislative initiatives as well as other bills affecting the ASRS.

The following bills have been assigned to the Government and Higher Education Committee:

- HB2338, ASRS; Disability Program – to remove “total” as it precedes “disability” to reduce confusion to members who may think they must be totally disabled to qualify for disability benefits. This bill received some concern but with the clarification provided, it was approved in the House and will be heard by the Senate Finance Committee on March 4, 2015.
- HB2339, ASRS; Rules – remove “provided in rules” in A.R.S. § 38-703 due to this being related to something that the Social Security Administration has jurisdiction over, not the ASRS. Strike “subject to rules prescribed by the Board” in A.R.S. § 38-755. No concerns were raised with this bill. This bill has been approved in the House and will be heard by the Senate Finance Committee on March 4, 2015.
- HB2340 – ASRS; LTD Program; Liability – protects the ASRS or the LTD Program from bad faith claims and requests the ASRS have the same protection from liability as ERISA Plans. This bill did receive some concern in the legislature because it was felt the language originally drafted protected the ASRS from any claim and not just bad faith claims. The legislature was assured that the ASRS was only interested in receiving the same protection as ERISA Plans. The language was modified and an attempt was made to address concerns regarding the aggregation clause within the State Constitution by providing case law pertaining to that issue. However, that did not alleviate some of the concerns in the House because it was not assigned and heard by the February 20, 2015 deadline. Mr. Ponder will continue to work with staff after the legislative session to modify the language so it can be heard in the 2016 Legislative Session. The Board asked that data be maintained regarding financial losses incurred by the ASRS that are a result of the failure to take requisite action with regard to these claims.

The following Senate bills passed out of the Senate Finance Committee:

- SB1095, Community Colleges; Optional Retirement Plans – to specify the ASRS transfer member accounts of NON-RETIRED members only. The ASRS currently does not have a method for transferring the account of a retired member. This bill passed through the Senate Finance Committee and then in the House Government and Higher Education Committee on February 26, 2015. Mr. Ponder predicts this bill will be placed on the Consent Calendar in the near future.
- SB1096 – ASRS; Actuarial Valuation Method – to allow the ASRS to change its actuarial evaluation methods from Projected Unit Credit to Entry Age Normal or some other method as determined by the Board. This bill passed through the Senate Finance Committee and will be heard in the House Government and Higher Education Committee March 5, 2015.
- SB1097 – ASRS; Health Insurance Benefits - ASRS 2015 Legislative Initiatives – a conforming legislation bill. This bill passed in the Senate Finance Committee and will be heard in the House Government and Higher Education Committee March 5, 2015.
- SB1119 – ASRS; Purchase of Credited Service - approved at the January 30, 2015 Board Meeting – to modify language with respect to the service purchase statutes A.R.S. §§ 38-743, 38-744 and 38-745 as a result of the *Pendergast Case*. This bill passed through the Senate

Finance Committee and will be heard in the House Government and Higher Education Committee March 5, 2015.

The following are bills that affect the ASRS but not initiated by the ASRS:

- HB2137, sponsored by Rep. McCune Davis, was presented last year as HB2212 and attached to HB2058 as an amendment which failed last year. This bill, if passed, would reduce the threshold from 30% to 15% and define “promotion.” This bill was not heard in the House Government and Higher Education Committee by the February 20, 2015 deadline. It is now dead as a stand-alone bill and it doesn’t appear that there is another bill, in this legislative session, to which it can be attached.
- HB2351, sponsored by Rep. Fann, would change the definition of a member of PSPRS as it relates to fire chiefs based on whether they are regularly assigned to hazardous duty, as determined by that individual’s local board. This bill was dual assigned to, the House Government and Higher Education Committee and the Military Affairs and Public Safety Committee. Due to some concerns raised, the sponsors agreed to work with Public Safety, as well as the Fire Chiefs and the Unions to draft a floor amendment, effectively allowing these individuals to join the PSPRS 401A Defined Contribution Plan. It appears that the ASRS will be fully removed from this bill, depending on how the floor amendment is written.
- SB1121, sponsored by Sen. Lesko, to strike the language “before July 1, 2015” from the statute thereby allowing anyone 65 and older to opt-out as long as they have not had prior ASRS membership and there will be an emergency effective date. This bill has not yet been assigned but it is likely to be assigned to the House Government and Higher Education Committee.
- SB1379, the purpose of this bill is to extract Arizona State University (ASU) from the ASRS and establish its own personnel system and its own health insurance plan for employees. This bill was dual assigned and not heard in the Senate Finance and Education committees by the deadline and is dead as a stand-alone bill for this session.
- HB2446, the purpose of this bill would be to allow the Arizona Board of Regents to study the benefits of developing independent retirement, health care and risk management programs. This bill was not assigned or heard by the deadline and is dead as a stand-alone bill for this session.
- HB2484, the purpose of this bill is to repeal statutes requiring ASU to distribute income from licensing and patents. Mr. Ponder stated that he put this bill on the tracker because he expects some sort of amendment to be offered in the Senate and therefore, would like to track this activity to keep the Board abreast of any changes.

Mr. McCarthy acknowledged the hard work of the ASRS staff and thanked them for their efforts in getting the bills passed and keeping the Board abreast of the changes. The other Trustees shared the same sentiments.

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

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 provided an overview of the investment report and advised the Board that some of the report formatting will undergo changes in the near future.

Mr. Dokes commended Mr. Karl Polen and Mr. Dave Underwood for their participation in the recently initiated investment seminars/internal round tables to discuss germane topics.

6. Presentation, Discussion and Appropriate Action Regarding Independent Reporting, Monitoring, and Oversight of the ASRS Investment Program

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 December 2014.

As of December 31, 2014 the Total Fund's market value was approximately \$34.2 billion.

For the one-year period ending December 31, 2014, the Total Fund returned 6.2% (net of fees), outperforming the Interim SAA Policy by 1.9%. For the three-year period, the Total Fund produced a return of 12.4% per annum, outperforming the Interim SAA Policy by 0.7%. Over the past ten years, the Total Fund has returned 6.6% per annum, and since inception, the portfolio's performance is 9.9%.

7. Presentation, Discussion and Appropriate Action Regarding the Asset Allocation Study Recommendations

Mr. Paul Matson, Director, Mr. Gary Dokes, Mr. Allan Martin and Mr. Chris Levell, Consultant, NEPC, addressed the Board regarding the Asset Allocation Study and the recommendations and responded to questions from the Board. In order to provide the Board with a thorough understanding of the recommendations being made, the duration of the presentation was approximately 70 minutes.

As a result of many discussions and analyses over the past several months, NEPC and ASRS developed a final recommended new Strategic Asset Allocation Policy (SAAP) which incorporates strategic investment themes while providing the ability to take advantage of present and anticipated opportunities in the financial markets. The recommendations to the Board were as follows:

- Reduce Allocations to Public U.S. Equities, Emerging Market Debt, Commodities, Core Bonds, Emerging Market Equity, and High Yield Debt
 - Rationale: Reduce growth-reliant and higher volatility exposures, and allow for increased allocation to credit opportunities.
- Increase Allocations to Private Debt, Public Non-U.S. Equities, Real Estate, and Private Equity
 - Rationale: Reduce net foreign exposures, reallocate foreign exposures to developed equity markets, and maintain a comprehensive set of asset class exposures especially to private markets where capital availability is needed.
- Add Treasuries as a separate asset class, and retain Infrastructure and Farmland/Timber, each with a 0% Target
 - Rationale: Increase the inflation linked and real asset opportunity-set while maintaining sensitivity to timing of entry and alignment of interest between asset class vehicle and underlying long-lived assets.
- Rename "GTAA" to "Multi-Asset Class Strategies" and reduce allocation from 10% to 5% with a 0-12% target range, and partially restructure by replacing some beta exposure with alpha exposure
 - Rational: Denoting these strategies "above-the-line" more clearly reflects the nature of the beta or alpha strategies risk/return profiles and improves operational management and reporting.
- Establish Policy Target Ranges primarily at the broad asset class categories
 - Rational: Controls for risk while still maintaining flexibility for tactical opportunities.

- Remove Minimum Passive % Targets for public equity and fixed income
 - Rationale: Consistent with Investment Beliefs and reflects ASRS perspectives on asset class efficiencies.

Mr. Tom Manos left the meeting at 10:18 a.m.

Motion: Mr. Tom Connelly moved to approve the Asset Allocation Policy Schematic as denoted in Exhibit A (attached) of the presentation as recommended by the Investment Committee, and as recommended to the Investment Committee by the Director, CIO, and NEPC. Dr. Richard Jacob seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 1 excused, and 3 vacancies, the motion was approved.

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

Mr. Paul Matson asked Mr. Anthony Guarino to provide a summary of the recent phone issues the ASRS experienced and update the Board regarding the action being taken to rectify the issue.

Mr. Guarino advised the Board that the ASRS recently experienced an outage of the voicemail system due to a hardware failure. Rather than incur the expense for repairs, the transition to the new State phone system was moved up and all non-Call Center phones are scheduled to be replaced. Staff will be working over the weekend with the State's AZNET group so that all replacement phones will be installed by Monday. It is a more complicated process replacing the Call Center phones and since voicemail is not used often by the Call Center their phones will not be replaced at this time.

Mr. Matson announced to the Board that Mr. Brian McNeil resigned as a Trustee and requested to make some comments regarding Mr. McNeil and his service as a Trustee. Mr. Matson stated that Mr. McNeil was a very engaged Trustee and the knowledge of information technology security was extremely helpful to the ASRS. Mr. McNeil's insight regarding legislation was also very positive and beneficial for the Board and staff. Mr. McNeil was very member-focused which was really appreciated. Mr. Matson expressed that Mr. McNeil performed with a high level of integrity, focus and high degree of interest, not only with the ASRS but the ASRS members, which was very much appreciated. In Mr. McNeil's absence, Mr. Matson extended a "thank you" to Mr. McNeil for the time he served on the Board.

The Board thanked Mr. Matson for his comments and shared his sentiments.

Mr. Matson took a moment to express his appreciation to Mr. Tom Connelly, Prof. Dennis Hoffman and Dr. Richard Jacob for their involvement with the Investment Committee and the hard work put into the recent Asset Allocation Study. Mr. Matson stated that he appreciated working with such an affable group. Mr. Matson further stated that he believes this approach led to a much superior product and extended his thanks to all who were involved with the Investment Committee meetings.

9. Presentation and Discussion with Respect to Informational Updates from Prior and Upcoming Committee Meetings

a. Operations and Audit Committee (OAC)

Mr. Jeff Tyne announced that the next OAC meeting will be held on March 10, 2015 at 10:30 a.m. in the 14th floor conference room and will focus on the five-year strategic initiatives plan.

b. External Affairs Committee (EAC)

Dr. Richard Jacob announced that the next EAC meeting will be held on March 13, 2015 at 10:30 a.m. in the 14th floor conference room and will include updates regarding the legislative session and initiatives.

c. Investment Committee (IC)

Mr. Tom Connelly announced that the next IC meeting will be held on April 20, 2015 at 2:30 p.m. in the 14th floor conference room and will focus on the equity asset class, both private and public, updating the Investment Policy Statement, an investment risk assessment and asset allocation for LTD and the System.

10. Board Requests for Agenda Items

No requests were made.

11. Call to the Public

A member of the public, Mr. Brent Fine, requested to address the Board on behalf of himself and the Arizona State Employee and Retirees Association. Mr. Fine shared his concerns regarding the stability of the ASRS if the State Universities pull out of ASRS for new employees and the effect on the State if the rest of the university employees go to a 401K plan, should this legislation get passed in the future. Mr. Fine also expressed a concern that the State may consider the ASRS as a source of funds to use for education and "other areas," rather than implementing a tax increase and asked if the Board has looked at this possibility.

Mr. McCarthy assured Mr. Fine that these issues have been looked at by the Board and thanked him for his comments.

12. The next ASRS Board meeting is scheduled for Friday, March 27, 2015, at 8:30 A.M., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

The public meeting was adjourned from the 10th floor Board Room at 11:02 a.m. and moved to the 14th floor conference room.

13. Presentation, Discussion and Appropriate Action Regarding the Office of the Auditor General's Sunset Review of the Arizona State Retirement System, including the Arthur J. Gallagher & Company Investment Management Audit

Motion: Dr. Richard Jacob moved to go into executive session for the purpose of discussion or consideration of records exempt by law from public inspection. Prof. Dennis Hoffman seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 1 excused, and 3 vacancies, the motion was approved.

The Board convened to executive session at 11:13 a.m.

The Board convened to public session at 11:43 a.m.

**14. Presentation and Discussion Regarding the Arizona State Retirement System
Administrative Appeals Process including Administrative Law Judge (ALJ) Decisions and
the Role of Trustees with Regard to Accepting, Rejecting and Modifying an ALJ Decision**

This agenda item was not heard and will be presented at a future meeting.

15. Adjournment of the ASRS Board

Motion: Mr. Jeff Tyne moved to adjourn the meeting at 11:44 a.m. Prof. Dennis Hoffman seconded the motion.

By a vote of 5 in favor, 0 opposed, 0 abstentions, 1 excused, and 3 vacancies, the motion was approved.

ARIZONA STATE RETIREMENT SYSTEM

Melanie A. Alexander
Board Administrator

Paul Matson
Director