Quarter Ended 6/30/09 Performance Meetings

August 27, 2009

Retirement Fund Conference Room

Board of Trustees Present:
Joe T. San Agustin, Chairman, Board of Trustees
Wilfred P. Leon Guerrero, Ed.D, Chairman, Investment Committee
Gerard A. Cruz, Member
Antolina S. Leon Guerrero, Member
Katherine T.E. Taitano, Member

Staff Present:
Paula M. Blas, Director
Diana Bernardo, Controller
Rosalia Bordallo, General Accounting Supervisor

Other Present:
Terry Dennison, Mercer Investment Consulting
Mike Perez, Great West
Alice Taijeron, Great West
Doris Flores-Brooks, Public Auditor

Defined Benefit Plan: Pages 1 to 15
Defined Contribution Plan: Pages 16 to 24

Defined Benefit Plan

Aberdeen $700,000 Settlement Offer:

Gerry Cruz: We can go forward, I'm just saying we may be missing an opportunity if we're not clear in identifying exactly how much of the transition portfolio is actually in commercial mortgage backed securities. I think he was writing to Aberdeen on a different premise though, I don't think he got legal advice from our legal counsel yet that commercial mortgage backs are an impermissible investment. Director Blas: What he did was looked at our investment statute and investment policy guidelines and went through the portfolio and only 3 of them were not in compliance. Gerry Cruz: But I think they were not in compliance for reasons other than being solely commercial mortgage backs. My point is that if they purchased any commercial mortgage backed securities, then they were out of compliance and so any losses on any commercial mortgage backs they should make us whole, not just the 3. Board Chairman San Agustin: My understanding is it's these 3 identified securities not in compliance and any other securities are ok. Gerry Cruz: I don't know, if we can get a list of the commercial mortgage backs, I can speak a little more definitively, but at this point without going into each one of these, it's hard to tell whether

they're asset backs or regular mortgage backs. Board Chairman San Agustin: That may be so, but what they've identified for settlement is only 3 securities, we're not giving up our rights on other securities that aren't identified here. Gerry Cruz: We need to be careful because the settlement is going to require that we hold them or indemnify them. If that's the case, if we're only indemnifying him on the claims for those 3 securities, then ok. Board Chairman San Agustin: They've identified those 3 and that's the point of discussion with Aberdeen, what they're going to settle, anything else is still up in the air. Gerry Cruz: That was actually pretty quick. Board Chairman San Agustin: My understanding of Terry is these people are very sensitive to market reaction, anything controversial, that if you go to court on unauthorized investments, these people may go to jail, it's the reputation side of it, they don't want to be dragged to court. James Taylor: The other thing is the quality of the case, if it's a slam dunk case, why bother litigating it? Litigation has its own cost, the quick out might be the best out for them.

Fund Chairman San Agustin: The company identified these 3 securities, that's why the calculation of what is the original cost of these securities and what is the present value plus all the income that we received as part of an investment and then you figure what the pay off and you still have it. Gerry Member Cruz: I just don't want to close the door to further research. Board Chairman San Agustin: The point is, how many more, are there any more other than the 3 and are we relinquishing on this settlement, does that mean we can't go back to them if we find out further issues. Antolina Leon Guerrero: How do we find out? Gerry Cruz: The easiest way would be to go back and search for, take a look at this portfolio, this $32.9million portfolio and determine which one of these securities are commercial mortgage backs. Joe T. San Agustin: He looked at the entire portfolio and out of that, he pulled 3 out. Gerry Cruz: I don't think that Blair understood that commercial backs were an impermissible investment at the time that he did his search. Director Blas: That was specifically what I asked for. Gerry Cruz: He only found 3 out of a $32.9million portfolio? If that's the case then we're ok. I recall the conversation with Steve Weiss, when he came in during his due diligence making the comment that they're are several commercial backs and he wasn't explicit as to how many, but several existing commercial mortgage backed securities that he'd like to exchange out and we asked him to hold until we were able to clarify the situation. Director Blas: Out of the list they held, he identified 3 which at the time of purchase cost about $4.3million.

Rosalie Bordallo: A question that needed to be answered was, what was a legal investment, if that kind of investment was a legal investment. I'm not sure he was looking at that question in particular when I read his response. Gerry Cruz: I remember him saying that the law was a little vague, that in the absence of an explicit prohibition, the argument could be made that the law was silent. As an attorney, you could put up any kind of defense, that's your job, but he's looking at that side, but if we get a legal opinion and our other manager has been operating on the premise that commercial mortgage backs are impermissible, then I think we have a stronger case. I'm all for a settlement when we can get one, I just don't want to close the door on the opportunity that there may be more. Board Chairman San Agustin: We need to clarify that with Blair, this was only agreed to those 3 identified, anything more may be covered now or in the future... Gerry Cruz: We were particularly hard with Oppenheimer during that Enron situation and rightly so, but I think we need to hold the managers feet to the fire when something like this happens. Investment Committee Chairman Leon Guerrero: I think it may be too late because we

already agreed to settle. Gerry Cruz: The question was whether or not to indemnify them completely or just for these. My limited experience with issues like this have been that we'll get a settlement letter from Aberdeen and the agreement is going to indemnify them on certain issues. Board Chairman San Agustin: We need to clarify to Blair, we're only talking about these 3 that you have identified.

Investment Committee Chairman Leon Guerrero: I think the next issue is, what are we going to do with those so called illegal purchases. Director Blas: Right now it's in the transition portfolio and it's still being held by IRM. Board Chairman San Agustin: Can we sell it? Gerry Cruz: He's made the claim that he can sell it and the reason for the transition portfolio is the price that is being offered for these securities is really low. Board Chairman San Agustin: We add that plus the settlement plus all the income that was generated. Gerry Cruz: We'll take a capital loss. Right now we're looking at an investment portfolio just for the asset backs, the commercial mortgage backs and the traditional mortgage backed securities, we have approximately $33million, that's principal and that's market value as of today. $33million is market value and that's approximately 59% of cost, so we'd be taking a 40% cut. Board Chairman San Agustin: The $33million you're talking about covers more than those 3 securities. Gerry Cruz: What are the 3 securities? Director Blas: Two Countrywide, and one Resident. Gerry Cruz: Do you have the description because there's several Countrywide? Director Blas: 2006 the S6 and 4 6 A6 and the other one was 2007 S1 A1A. Gerry Cruz: So market value for the 1st one, the A6 is now $345,000 rounded, that's market value and that's trading at 30% of the dollar. Director Blas: It's $329,000 and then the resident is 2006 H14A1, that's the last one. It's about $700,000.

Gerry Cruz: We still retain ownership of these securities. Investment Committee Chairman Leon Guerrero: If they were newly purchased, we need to advise them to get rid of it. Gerry Cruz: As long as we do not close the door for future settlements, I think it's a good deal. Rosalie Bordallo: Gerry brought up a valid concern that if we find out that those were illegal securities and we find out that there are other illegal securities purchased here, you're going to force yourself now to say, you need to liquidate all the illegal securities. If the Board finds out there's an illegal action, you can't ignore the illegal action and that's what Gerry is saying, once you've made it known it's illegal, then you have to apply it across the board as illegal. Wouldn't it be better for us to identify everything that's illegal before we start telling the manager to liquidate its illegal securities? We don't know what's illegal and what's not and that is my concern. Gerry Cruz: In the meantime, we have an offer on the table so there's nothing to preclude us from accepting this settlement for these 3, but we don't have to touch the portfolio yet. Our investment laws are written to be permissive, meaning they're explicit as to what we can invest in, so anything outside of that would be a no, which is why we had to pass law to allow us to go beyond certain things and to validate that point, our other investment manager that's in the same space, knew this and acted accordingly. So, we will move to accept Aberdeen's settlement offer, $700,000 specifically related to those 3 identified securities. If a security is illegal from the start, meaning you can't buy it, how can an argument be put forward that justifies owning it? Investment Committee Chairman Leon Guerrero: The recommendation for the settlement is for use for operations.

Metropolitan West August 7, 2009 Letter:

Terry Dennison: The letter from Metropolitan West, they're citing because of the ADR restriction, they're unable to purchase 2 securities Santander ADR and a Mitsubushi ADR that they would like to hold. They believe because of section 8158, C. 1, that holding those ADRs would not be permissible and they would like to in lieu of those, have a 3% position of their portfolio in XLF which is a financial sector spdr and they're asking if this would violate the investment guidelines. Just for information, the spdr is an ETF. So to my mind and this is not a legal opinion, this is no issue, they're free to buy an ETF. The ETF language allows up to 20% ETFs, right now we're using 2%. Rosie Bordallo: They fall under the commingled category and the mutual fund category, 30% allowable total fund and we're up to 20% because we have AXA, Capital and DFA. Gerry Cruz: It's an ETF that indexes international financials, but how does this fit their mandate because they're a U.S. domestic value manager? We allowed them at one point because we didn't have international managers, so they gave us international exposure through the ADRs, but once we hired the international managers, we asked them to pull back on that. Rosalie Bordallo: Once we hired Fisher and brought in DFA and AXA, we sent out letters notifying all managers that they don't have to liquidate any ADRs they have at that time, but going forward from the time of the letter, they are not to purchase anymore ADRs, that we do have an international manager now that would be taking that position. Investment Committee Chairman Leon Guerero: So a response to this letter is not necessarily a violation of our investment guidelines, but it's a violation of their mandate.

DB Plan – Quarterly Performance

Investment Committee Chairman Leon Guerrero: We want to take a look at the actuarial rate of return and revisit it, why do we want to do that? Director Blas: Right now we're currently at 7% and we wanted to revisit that, whether that 7% is still the rate we want and can achieve. Terry Dennison: I had talked earlier about a likely period decade, longer, shorter, where it's going to be much more difficult to achieve investment returns than it was in the past. I think we're going to be in a period of slower growth, partly because of the drag of higher taxes, the drag of more Government regulation, so if you look at the components of your investments, for example we're forecasting right now equity returns of 8% and bond returns of about 5%, so you could construct an asset mix that would achieve 7% or 7.5% if you have a safety margin. If because we're in the low growth environment or an environment where there are constraints in the system where basically equities can only produce 6% and bonds 4%, realistically assuming that you could generate 7% returns becomes unrealistic. So, I think you do have to consider the possibility of lowering the actuarial assumption in light of the likely environment that we're going to have in the next 10 years versus the environment we've had for the last 25 years. It's not going to be as easy to make money as it was for the last 25 years. Board Chairman San Agustin: Approaching from a real estate view point, the likelihood of achieving 7% cannot be so therefore it's safe to say 6% and then work on that, but then the next step it's going to trigger contribution rates. Terry Dennison: Yes, you're going to see a funding level drop to maintain an actuarially sound funding level, contributions are going to have to increase.

I don't think you have to look at the actuarial assumption more than every couple of years, things just don't change that fast. It's not something we're making any changes to our assumptions, it's not a cyclical thing where the next couple of years is going to be really good and the next couple of years is going to be really bad, we could be looking at a decade or two of slower growth. (Every 2 years)

Investment Committee Chairman Leon Guerrero: Asset allocation policy? Terry Dennison: I would say it should be looked at yearly and a study be done every 3 years, that's the general practice. Rosalie Bordallo: At a minimum, it's suppose to be done every year. Investment Committee Chairman Leon Guerrero: Rebalancing of the portfolio? Terry Dennison: I would say the best practice would be to look at it quarterly. That's an aspiration, you can't guarantee it would happen. I think part of these are things you commit to doing as a process, you commit to quarterly reviews, that's an aspiration. Investment Committee Chairman Leon Guerrero: So, that's a yearly review. Perform a feasibility study for a new building, what kind of building are you building? Rosalie Bordallo: We have no concept of how much it's going to cost and that's why we want to have a feasibility study, 6 months should be adequate to tell us how big the building should be, you need to know what you could do with your land before you do anything with it. Terry Dennison: I think another goal you should have is to annually review the legislation regarding investments and to not necessarily have a yearly legislative program, but to assess whether or not the present investment objectives are serving the plan well. Let me give you an example, Joanne called me and asked what I thought about this CNBS business from an investment perspective and literally these things were never even contemplated in the legislation. It isn't obvious how you would even think about them. So I think periodically it would be good practice to look and see what is becoming a problem. We've been doing that informally now, we did it with regards to the ETFs, we did it with regard to making space for commingled vehicles and mutual funds. I think we need to periodically ask ourselves what would we want from the legislature that would make this plan more efficient and effective from an investment perspective, because the present legislative structure does not contemplate new investment vehicles, new investment structures, and are frankly already causing ambiguity as to what's allowed and what's not as well as eventually going to become an actual cost either in terms of lost returns or increased risk because of the inability to diversify, and I'd do that annually. (End of Discussion)

<u>DB Plan – Funding of the Following Managers:</u>

1. Thomson Hortsman & Bryant – Not Yet Funded

We have had since the last strategic allocation a 10% of total fund allocation to U.S. small cap. The object here is diversify some of the risk right now that's concentrated in large cap and over the long term, this is not a forecast of the next quarter, but over the long term, small cap has outperformed large cap if you just look at the indices. The manager that was selected, THB, we suggested holding off funding them. I think I shared at the last committee meeting our researchers' view, he has expressed concerns about the people side of their business, 2 of their founders are approaching retirement, several new individuals have been brought in to assume their role which is the usual model for generational transitions. One of the individuals, he was impressed with, the second less so. The one he

was less impressed with seemed to be a little bit more aggressive with perhaps a little less thought than he felt comfortable. The other of the senior individuals, he was very impressed with. He was also concerned that the portfolio was run on a seemingly team basis and that there's no single decision maker, but that portions of the portfolio were run by portfolio managers who specialized in one or the other sectors. His concern was the people who weren't involved with the healthcare sector really did not understand why it is they were holding particular securities in healthcare and that there wasn't a lot of team like communication. They were in our office last Monday and I spent more than an hour with them, in fact I posed a question to them, is this more the Cap Guardian model where they have a team of portfolio managers who run sleeves of the portfolio relatively independently and they said, no it is not that model, they're aware of the concerns that our analysts had and feels that there's some truth to them, but that they actually do communicate a lot internally and really do have an understanding of each of the securities that's held in the portfolio.

Clearly the portfolio manager who specializes in that sector has a deeper knowledge than people who don't. Their target return is 200 or 300 basis points over the benchmark, over a market cycle which is not an uncommon return in this asset class, you would invest in small cap accepting the risk of small cap which is more than you would find in the risk for large cap for that incremental return. We did look at their historical performance and generally they achieve that, they had a bad year last year, but that was hardly a unique circumstance. If you look at them for longer periods, they generally have achieved what it is they said they would achieve. There is an issue with how this particular asset class is funded long term, the various asset classes provide different opportunities for active management to add value. It's generally believed that it's more difficult for active management to add value in large cap and in fixed income because there's so much coverage of the securities in those asset classes, it's very difficult for a particular manager to discover something that everybody else doesn't know. The technical term for that is efficiency that the present prices recognize or contain the implications of all that is known and knowable about the company, that research actually does you no good because you can't discover anything that everybody else doesn't know. In small cap securities there is less coverage, there are fewer analysts following small cap companies than there are following a Microsoft or an IBM that there are opportunities to add value and historically active management in small cap has outperformed the index, sometimes by a broad margin, sometimes by a lesser margin. So long term, we don't want to park the money in an ETF because that is tracking the index and we are giving up something. So the question is, are we sufficiently comfortable with THB, not necessarily to give them the whole 10%, which is a lot of money, that's more now than $100million, but on the other hand so far and I guess when the analyst who works with me on this said actually the ETFs only have 1%, I was a little surprised because I thought the intent was that they would have the whole 10% in ETFs, but the question is, do we want to fund perhaps a portion of THB and this becomes the ultimate judgment call. Our manager research people who we listen to and respect, have rated it a B which is average likelihood of out performance adjusted for risk, there are other managers that we think have a higher probability of adding value, some of them regrettably are closed, they're not available because small cap has capacity constraints, you can't have a small cap fund that becomes monstrously large because either you dilute it by holding more and more names which means that the really good ideas are diluted by not so good ideas or you start to buy larger and larger companies which means it's no longer a

small cap fund. So we don't have access to some of the managers we would perhaps like to have that we think more highly of.

I was impressed by the THB people, they were very forthright about the problems they had last year, they certainly understood what our concerns were, our analyst did share his analysis with them that he doesn't have to do, but he felt that they earned that and I guess and I've talked to some people internally, we would be willing to recommend partially funding them. Perhaps taking down the money that's in the ETFs or leaving the ETFs and just adding fresh money to this place, but I think given where we are in the market cycle and in fact this was an integral part of the strategic asset allocation and there was a presumption that this would be funded to approximately to at some point, the target level and all of the asset allocation and assumptions about risk and return, total portfolio volatility and expected performance are predicated on this class being funded. I think it would be appropriate to either fund them partially, add more money to the ETFs, look for another manager or something else because right now, we have a hole in the structure and to remind everybody and this is perfectly parallel with what I said this morning, it's not just that we don't have any small cap, it's just the money that was set aside for small cap is sitting some place else. It's not just that we have a hole and a potential opportunity loss, we have an overweight that the asset allocation didn't contemplate, the asset allocation didn't assume that we would have this money parked in large cap, so right now we're not only under weighted in small cap, we're over weighted relative to the strategic asset allocation in large cap.

As I said I talked internally and thought about it and my sense is at this point I would be comfortable with funding them at 40% of the target which would be 4% of the total fund. It's enough to move the needle, it does matter that you expose yourself to risk as soon as you give them a dollar, you don't want to do stuff that has no meaningful impact on the portfolio. Don't fiddle around with the little stuff because it doesn't have any meaningful impact. Assuming that we're approximately 1% of the funding level of ETF, I would have no problem keeping that 1% in ETFs giving 4% to THB which means total exposure is 5% which is half. Rosalie Bordallo: We're almost at 2%. Gerry Cruz: Target is 10%. Terry Dennison: We're talking about half and I would take it from large cap because I'm actually more concerned about the over exposure to large cap than I am the under exposure to small cap. The whole idea of diversification is to have lots of money in lots of different places and we're over exposed there and if anything, small cap hasn't had relative to it's under lying valuations, the run that large cap has. I think we're more exposed to losses in large cap than we are to losses in small cap. I would keep the ETF level at whatever it is which would put total exposure at more than 5 less than 6, that's half way, it has enough impact to the portfolio that it does reduce the risk. So Mercer's recommendation is do not buy further ETFs, hold what we have, maintaining exposure to the asset class but a sort of passive hedge, give 4% of the total fund, 40% of the allocation to THB. Rosalie Bordallo: Hiring another manager was an option, my suggestion is you might want to just split the 10% into 5 and 5, you do item 1 and you keep the ETF, but at the same time you start a search for an additional manager in that category, he (Terry) threw out 3 options & I'm addressing the 3rd, you still keep THB, but at the same time since you have some hesitancy with them, we're not in a rush now because we have funded small cap up to 6%. Terry Dennison: Ultimately I want to have it funded at 10% because when we built the asset allocation structure, everything was built around the asset classes being around their targets.

Everything has to add up to 100 which means if this is at 6, we're missing 4 which is someplace that wasn't planned on being. We have the same issue with REITs too, but I have no problem with that, basically doing another search, we would have 6, we would give them 40%, if they keep doing well, we hire the new manager and just do 5 and 5, give them another 1%, give the ETF money and 3 more percent out of the large cap to the new manager. That would give each manager $50million, I don't want to have a situation where we give managers $20million because that's just not worth the bother, $50million is a nice minimum to have. Rosalie Bordallo: If you go with doing a manager search, you would get rid of the ETF once you get the new manager on board and also liquidate. Investment Committee Chairman Leon Guerrero: I would like to keep that ETF, we just started the ETF and it hasn't been a year. Rosalie Bordallo: You want to fund the 10%, so if you want to keep the ETF, then you may as well go the full 10% now. Terry Dennison: I would suggest the decision today given Rosie's comment, give THB 40%, maintain the ETFs, start a search for a new manager, so we'll have 6% exposure, 60% of the target allocation, when we get a new manager, we can give them 4% and keep the 2% in ETFs, we could bring everybody up to 5 or some other close.

2. Cornerstone – Partially funded
3. Security Capital – Partially Funded

Terry Dennison: We have provided you with some articles that were in the Wall Street Journal addressing REIT issue. We talked earlier about the real estate investment trust, they invest in a wide range of real estate investments and the principle categories are retail, hospitality, industrial, multifamily, there's a few other subcategories. One of the advantages of active managers is everybody knows retail stinks, so the active managers are avoiding that like the plague unless they can see just a screamingly outrageous attractive deal. There are some very distressed real estate properties for sale and they might say this is a bargain that's too good to miss and actually be adding to their retail and if you can pick up a regional mall for 40% or 30% of its replacement value because the present owner is very distressed, that's a very opportunistic investment. We have seen the volatility of this asset class, if you've seen the report, it's up and down all over the place. It does provide a degree of inflation protection in that it is buying physical assets and if inflation becomes relatively large or relatively significant, practical fact is the properties probably grow in value or don't fall in value as much as you might expect because there is some inflation protection built into it. Right now this is 10% of total fund, this is one of those diversifying assets, moving money out of other asset classes, this money is parked in fixed income, the reason being that while these are equity securities and have equity like risk, you can think of it as a little bit more fixed-income like than pure equity. Right now we did fund each of the managers, Cornerstone which is a more diversified manager and Security Capital which is a much more aggressive manager, it has in our ranking system, the T sub code indicating that it generally produces very high levels of tracking error at 2.5%, so we have a 25% funding of them.

We look at the issues around this and not only have there been articles from wall street journal, but there are articles in other trade press that talked about the likely fortunes here. We did speak with our real estate analysts about their sense of this market. I think our recommendation is to go to 50% with Cornerstone but keep Security Capital at 25%. We're just not comfortable with an aggressive manager in this environment, we don't want to lose

the inherent advantages of REITs as an asset class, which is a physical asset, an opportunity, this could be, if you are looking at an asset class from a manager perspective, if you are a good stock picker, this is a manager who's buying REITs, it is not a single REIT, it is a manager that's buying a portfolio of REITs, if they see a real estate investment trust that is making thoughtful opportunistic buys of distressed properties that is doing a good job at maintaining their rent role, their occupancy level, those are very attractive. In one sense if you're going to buy low and sell high which is the trick in investing, this is an excellent opportunity, there are a lot of distressed properties out there. We are I think more comfortable with the more diversified, less aggressive manager which is Cornerstone and would suggest going up to 50% of their target funding, we're less comfortable with Security Capital, frankly we're a little edgy about a concentrated manager, if they get a bet wrong, it's going to have a much bigger impact. So that would be our recommendation, go to 50% for Cornerstone from 25%. Board Chairman San Agustin: This article, it doesn't seem like we should go into this and doesn't link to the recommendation to fund them. Terry Dennison: They're cautionary to say the least. Joe T. San Agustin: It doesn't lead to the recommendation to fund them, they're going down, they're not gaining anything unless, and I know the commercial market is not doing so well. Terry Dennison: Agreed, now consider they could also be heavily investing in multi-family housing and there are a lot of people who have decided or who have been forced out of their homes that are occupying rental property at this point. That's the advantage in this case and there are other cases, of active management versus an index fund, this is not an asset class we would be comfortable indexing. What they're doing is buying and selling real estate investment trust securities. So, what this portfolio consists of in the case of Security Capital, 20/25 real estate investment trusts, each with their own investment objective, each with their own portfolio, in the case of Cornerstone, 60/70 real estate investment trust. So their job is to evaluate the thoughtfulness of the real estate investment trust process for identifying securities doing their asset allocation of their real estate investment trust, how they handle financing, all of those sorts of things. Absolutely, one of the things we're not suggesting to fully fund them is the same argument, reducing the risk we have now, concentration of fixed income, increasing diversification, if you think about this, we're only talking about a fairly small increase, 25% of half of 10% to Cornerstone.

Each one of the real estate investment trusts which is like a mutual fund, they're technically not mutual funds, they're a different sort of animal, but think of them as a mutual fund that owns properties. A particular REIT may specialize in a particular asset class like multi-family housing or hospitality, actually Starwood which owns Sheraton & Westin, is a REIT, Starwood technically a real estate investment fund. Their job as managers is to find real estate investment trusts that are making sound investments in today's market place. Investment Committee Chairman Leon Guerrero: This morning when you were talking about purchasing manager's index, what struck me was that it looks like the mall market was down, but if this trend, this purchasing manager's index, they're going to be in business again and I wouldn't mind investing in shopping malls. Terry Dennison: The bottom chart are purchasing manager's index, those are people in industrial companies who are looking at the orders that the industrial companies are receiving. (The top right chart, the red line is retail sales.) Obviously if industrial sales pick up, it's going to be good for GDP, at some point it's going to be good for employment which ultimately is going to make retail sales go back up. The purchasing manager's index is looking at future industrial activity.

The REIT index for 2nd quarter was up 30.6 %, the S&P was up 17%, so about twice as much. They are extremely volatile, if you look at page 39 of the big book and look at the bottom line, that's the REIT market median, the line above it is the index and those are cumulative periods. On page 128, I want to show you the performance in various years. On the bottom of 128, we're looking at the real estate index, in 2006 it was up 25 and in 2007 it was down 17, in 2008 it was down 40, year to date this year down 12, for the quarter up 31.7. So we're not looking at an asset class that's been running an all time high, we're looking at an asset class that is relatively depressed and again the objective here is to buy low and sell high. I would be cautious if the performance had been recently spectacularly good, because the most likely next move is down. Again right now, the money is parked in fixed income which means relative to our strategic asset allocation, which tried to find the most effective asset allocation to try to balance risk and return to produce the highest return for an acceptable level of risk, we are over weighted in one asset class and under weighted in another asset class for a good reason. The question is do we slowly move toward the overall target (Cornerstone). Security Capital we expect to ultimately have higher returns with higher volatility. I'm reading these articles and the concerns that are expressed and I'm not sure this is the right time to be going with an aggressive manager, it's already an aggressive asset class, that's aggressive times aggressive. Gerry Cruz: Our investments with them are liquid? Terry Dennison: The underlying REITs are traded every day, they could sell out their entire portfolio and get their money in 3 days and you can sell the REIT shares, you could get your money back in 3 days. The REIT owns the real estate, but you can sell the REIT shares without selling real estate. You're not buying real estate, you're buying a company that owns the real estate, it's a mutual fund in real estate. You wouldn't have the liquidity if you actually owned the underlying properties.

Wilfred Aflague: The basis for, other than Cornerstone, is for the other company to remain status quo? Terry Dennison: My concern is it is a touchy time for REITs, I read the articles, I am concerned that we may have another period of tough performance before we get to significant improvement. It's a risky time, they take an even more aggressive view, they buy fewer REITs, they're more concentrated and it's the risk times risk that bothers me. I would rather have a more conservative, more risk sensitive manager buying risky securities than a manager who seeks risk buying risky securities. So we're basically saying we're more comfortable with Cornerstone's strategy in this environment than we are with Security Capital. They're an interesting combination together and in the long term we think they will play well together, one is more conservative and one is more edgy, they don't do the same thing, their strategies are different so I think it's a good diversifying combination of managers, we just don't think it's a time for them right now. How many more quarters do you feel you have to look at it? We look at it every quarter, it has to do with where the market is, we're continuously assessing the managers, as we have been re-assessing when were thinking about THB. Gerry Cruz: I think funding Cornerstone is a good idea, they're a big firm and they invest in both REITs that are on the market but they also have direct exposure to actual properties so they're a little more diversified than Security Capital which I recall invests solely in REITs publicly traded. (This item is an action item for the 8/28/09 Meeting)

Other Items:

Securities Lending Update

Terry Dennison: In the process of securities lending, there was a risk that the collateral pools in which the cash collateral that the borrower could buy was invested in securities that lost value, which meant that when the securities were returned by the borrower, there wasn't enough money left in the collateral pool to restore the collateral that they were due. This impacted a great many securities lending agents, it did impact Northern more than most, because Northern had a range of collateral pools, some of which had very aggressive risk characteristics. In this case Northern, gets a portion of the income from the collateral after rebate to the borrower and your share of the remaining income, so the more aggressive the pool, the more income and therefore more revenue to Northern. They like many lending agents, had a range of pools, all of which suffered severely when we had the Lehman failure and general disorder in the bond market.

Many plan sponsors with securities lending programs suspended or terminated the securities lending program to avoid if possible, some of the damage that had already been done. The necessity to make good on the lost collateral, the securities lending contracts which were often not read thoroughly required that the Fund, make good to the borrower on these losses in these collateral pools and there have been very significant losses, CALPERs paid out a number near a billion dollars to escape from their securities lending program. Another public fund in the Midwest which was no where as near as big as CALPERs, paid $100million to escape from their securities lending program and securities lending in general has developed a toxic reputation. While the Fund wasn't directly affected, there was a collateral damage because many index funds had imbedded securities lending and all of a sudden the index funds were developing very negative tracking performance because they were impacted. We did talk with our group which does consulting in investment operations and clearly everybody learned their lesson from this because this has just been a very expensive debacle for everyone involved. Their sense is, everyone has gone back to basics, that nobody's actually doing bad stuff now and we no longer have the wild and crazy collateral pools invested in long duration loans, credit quality securities. Now the impact of that, the revenue is, in their words, a lot lower than it use to be, these deals are no longer the big dollars that they use to be, because interest rates are much lower, if you're going to basically have overnight money or very short duration, very high quality money with interest rates being what they are, the gross yield on the collateral pool is next to nothing. The borrower is able to get a rebate depending on the type of security and the difficulty of borrowing that security, the lender of the security has to pay a significant rebate then you have to divide what's left with Northern and the net result is, there's not much money in this anymore. That will change when rates start to go up. Previously this was relatively attractive because the collateral pools invested very aggressively and that allowed higher yields.

The question they posed to me when I asked them what do they think we should do, is what's the client's risk tolerance? The risk is now a great deal less than what it was, the yield is a great deal less than what it was, the yield is a great deal less than it was and we discovered that there was something that went wrong with the collateral pools, while everybody's going back to basics, nobody's doing bad stuff, we still don't know if there's something else that could go wrong and the question is, is there enough money left in this

thing worth the bother? The reality is if something goes wrong, you're on the hook, you' have to pay and it's not a case of going to the Board with a motion to pay, they just take the money out of your account, you have no choice. Rosalie Bordallo: You're saying, have we not learned anything in the securities lending program, the first thing you're saying is they didn't read their contracts which made them liable to come up with the collateral, if we were to get into that, would we not make that provision in the event that something happened, it's either a co-share, I would think that you would learn how to safe guard yourself better from the mistakes that are made in the past going forward here. If they really want to do the program, I would like to see how far they're willing to go to accept things. Terry Dennison: That's a question of fact and a legal question, not an investment issue. I would be, knowing how they think, I'd be very surprised, you're a small fish, it's a side show, they don't want to set a precedent, if they do it for you, they have to do it for other people. Northern knows what's in your portfolio, they know the lendability of it, they know the current level of their collateral pool earnings, they know what the borrowers are demanding in terms of a rebate, they should be coming to you rather than just have your consultant tell you it's ok, if that's actually what they asked. They should be coming to you and saying, here are your expected earnings for doing it. At a minimum, I would take the most conservative collateral pool guidelines, which means you get next to nothing. Rosalie Bordallo: Which was one of the problems to begin with, why we wouldn't get into it because they wouldn't provide the most conservative. Terry Dennison: They won't make any money. Eventually they will tell you it's not available to you because there's not enough money in it for them. At a minimum, you shouldn't act without some sort of analysis from them, they have everything they need, they have your portfolio, they can look at it and say what portion is lendable, because if there's not much in it that's lendable, if it's not stuff that borrowers are willing to borrow, they're not going to make any money. So they know what you have, they can assess its lendability, they know for the safest collateral pool's what the gross earnings are, they should be able to assess at least approximately what the rebate levels would be and tell you if you did it, what you would get. Right now you have no basis on which to make a decision, they're just saying, give me money, is basically what they're saying, you take this risk and give us money. You shouldn't say no without getting information, get the information. You need to have from a fiduciary perspective a sound basis on which to make an analysis which is, what would we get.

Funding of Emerging Markets

Diana Bernardo: When we received the bond money in May, the Committee decided to put the money into ETFs and domestic small cap, but the Chairman had thought we would be able to provide additional funding for emerging markets.

Terry Dennison: Right now looking at the data that Diana had provided, you're looking at 4.9% of portfolio, 3 is the target up to 6. The other issue we're going to have to deal with is if we put in 1% and it continues to outperform which it almost inevitably will, because most of the portfolio is fixed income, it will be over the maximum very quickly. So then we need to do something about that, so the question is, I wouldn't put something that puts us just under maximum, because all that's going to do is produce a necessity to reduce it relatively quickly. Maybe if you end up putting something ¾ of 1% to give us a little bit of space and the question is, does ¾ of 1% move the needle.

The other thing that could happen is, I've been citing the example of it doing better than the rest of the portfolio, it's doing 30 and the rest of the portfolio is doing 15, if the rest of the portfolio declines, you'll blow through that maximum very fast, that's the denominator effect. If domestic equity has a big of a pull back from the huge run we've had, it will continue to grow, you'll be over that 6% in a blink of an eye. That 6% is a Board issue not a legislative issue so the Board can act or in its wisdom, not act, it's not a legal issue. Investment Committee Chairman Leon Guerrero: It may tie in to what we're going to talk about later which is small cap, our 5 year plan. What I'm hearing you say is that we probably should widen this range here because you're right, it's at 5% right now. Terry Dennison: The issue about widening the range has to do with the absolute level of risk, you've already got a fairly high allocation to non-domestic developed market equity, clearly it's the best performing stable asset class, but I would be concerned if we increase it to such a large level that the total non-domestic equity allocation starts to get really big.

Investment Committee Chairman Leon Guerrero: If we put more money into this, we will be over the limit. Terry Dennison: We're going to be over the limit in reasonably foreseeable circumstances. Investment Committee Chairman Leon Guerrero: The Chairman is seeing opportunities to make money here, he wants to put more money into this thing. We have adopted a target allocation where we set it at no more than 6% max on this category and we're re-approaching it and what I hear Terry say is, if this changes or continues, next meeting we're going to be talking about increasing again. Terry Dennison: If you hit the maximum, if you went to 6% right now and hit the maximum on the developed, you'd be at 21% international. If you moved it to 7% so that you could put in another 1% which is enough to move the needle, you'd still have a fair amount of space. Right now the under developed market is under 14%, so you're right around 20%. I don't think we'd have to look at the asset allocation, look at the risk analysis if you only go from 6% to 7%, the system is just not that precise. So maybe the solution I'd be comfortable with instead of adding money to it and putting it right at the limit, raise the limit to accommodate the additional 1%, so raise the limit 1% and add 1%. Gerry Cruz: I'm not opposed to it, I think it's a good idea, but I'd like to look at this in more of an aggregate approach, because I'm not of the opinion that we should be tweaking stuff when we think the market is hot. The downside is, if emerging markets has had a good run as have all the equity markets, we could be at a point where it's at the top and if we start getting into the practice of tweaking it when we feel hot, then at what point do we stop, it could become a slippery slope unless we look at it in a more aggregate fashion and say that this is the strategic allocation that we agreed to and this is the time horizon going forward, this is what we want from our portfolio.

Board Chairman San Agustin: When you spread out your allocation, you see a 5% or 4%, so what you're saying, we're not going to raise that up to 10% at the expense of the other, you're right about tweaking, so what's the balancing. Gerry Cruz: So if we increased emerging markets another 1%, what does that do to our exposure in the international space in general, it brings us up to around 23, 24%. Terry Dennison: The maximum would be 22, right now your actual would be south of that. Gerry Cruz: If we are correct and that market outperforms the rest, then that takes up a bigger piece of the total portfolio and that's the upside. The downside is if it underperforms, then it could really weigh down on our portfolio. Terry Dennison: I agree with you that we shouldn't chase return, we shouldn't look at what's hot recently and go there because I think that's a prescription for

failure because the market psychology changes. This isn't really based, in my mind at least, on what's been hot lately, but rather the underlying investment thesis for it. We talked earlier about the emerging markets having basically avoided the down turn we've seen in developed markets, in fact very few of them actually produced negative results, Taiwan had very negative GDP growth, China basically went from 8% growth to 3% growth, it looked like a recession to them, but it really wasn't. So I think the investment thesis here is what's driving it, that the emerging markets have demonstrated that the decoupling thesis is wrong. The old motto was when the developed markets got a cold, the emerging markets got pneumonia, because basically they're business was selling resources and low value added manufacturing to the developed world. Reality is they're now doing high demand manufacturing and have significant domestic markets which are not as impacted. Is this risk less, is there a guarantee, of course not. There's a question of whether or not there's a bubble developing in China. Gerry Cruz: I agree with that. Do you see a significant change in the expected return or the risk level of our portfolio if we moved? Terry Dennison: The expected return will rise moderately, the risk will rise moderately, but you look at the relationship between risk and return, because diversification reduces the impact of the additional risk, it's raising it, but not proportionately. You are capturing the incremental return potential, but you're not getting a proportionate increase in the risk because you are diversifying the risk. The reality is it's growing significantly. Gerry Cruz: It has, but in September and October we also were down $24million in this portfolio from $50million. Terry Dennison: It's a very high volatile, in the old days it used to be up 80, down 50, up 40, down 30, but what we're seeing now is more consistency in growth because the economics of those markets have changed. They've demonstrated they're no longer dependant on the help of the developed markets; they've gone from needing money to being creditors. It's the U.S. from a structural perspective that's got the financial problems, not China; China has $1.3trillion in the bank of just our treasury securities, as well as a big buyer of Euro and British pound sovereign debt. It could look next month, next quarter like a really dumb idea.

Gerry Cruz: We have a plan and we have direction, so the question now is to stay the course or to tilt our plan a little bit. I'm looking at the returns and they're great this quarter, but we're still under cost by $21million despite having a return of 33. Terry Dennison: The quarter before was lousy. Gerry Cruz: As it was for every other mandate, but if you go to the large cap equity space, only Robeco is under cost by less than $200,000, everyone else is back in the money market over cost. Terry Dennison: The other thing you have there is, this is a relatively new mandate and frankly, the initial several quarters of it were very inopportune market, the time it took to get this actually funded took us sort of out of the period we could have made buckets of money. Gerry Cruz: We did, the first several quarters, the first year and a half we went from 36 initial funding to 42 to 56 and then we funded an additional $8million. Terry Dennison: Had you done it at the time a decision was made, you would add another 10 or 20 on top of that. Gerry Cruz: I don't disagree with you there, I just don't want to be in the practice, as you mentioned, of chasing returns.

Terry Dennison: On page117, this is the detail on the Cap Guardian emerging markets, what you see here is just wild performance either with the manager or with the asset class. In 2006 the median fund was up 33.6 and in 2007 40.6, in 2008 -54.0, so in 2008 it killed all of the gain from 2006 and 2007. Those 2 together would be doubling your money and

you lost more than half of it in the median manager. If you look at the indices, roughly the same picture, the very bottom, the MSCI emerging market index up 32, up 39, down 53. Capital did somewhat better than that, it only was down 49.3 which actually put it in the 20th percentile. Imagine an asset class where you are in the 1st quartile losing half the value in one year.

If we're only going to put in half percent, there's no need to move the maximum. (This item remains status quo.)

Defined Contribution Plan

Target Date Funds
Other

Terry Dennison: I passed out a booklet on life cycle funds. We were asked to do an explanatory of life cycle funds and there was some interest in looking at target dates for in addition to the target risk funds that you already have. If you turn to page 1, the way we view this is to look at the psychology of the decision making process that participants use. The issue here is to add a fund to the plan that facilitates participants making good investment decisions. Most participants don't have the time or the knowledge to make good investment decisions, they do a lot of perfectly human things, they chase performance, they don't understand the real risk of things and presented with a lot of options to look at, they often just freeze. There was a study done by the Wharton School using data from Vanguard that found that the more investment options you present to a participant, the lower level of participation, that people don't like to have to make decisions and often they simply say, but what is the safest fund, which in your case would be the stable value fund. So, what we've done here and this is just a conceptualization that Mercer developed, is looking at a number of different investor types and reference to behavioral finance and behavioral finance is an emerging science that looks at the behavioral aspects of decision making around investments, why people make the investments they do. For example, why are people very reluctant to sell losers, they hate to recognize a loss, they hold on to securities that are continuing to under perform, not only losing more money but also losing the opportunity cost that they could have invested in because they simply hate to recognize a loss.

There are a number of things that have been developed and one of them is the fact that people have different ways of thinking about investments. The first thing we cite on the left hand side is the reluctant investor, somebody who knows they have to save for retirement, recognizes they don't really have any knowledge, doesn't have any time and frankly is frightened of the whole business. On the right hand side, we've listed portions of the available array of options that best suit people with these behavioral characteristics. So the life cycle funds and again these can either be the target risk funds that you have today or target horizon or target date funds which are what we were asked to discuss, are best suited for the reluctant investor because you buy it and you forget about it if you want. There are reasons why forgetting about it at least in the long term is undesirable, but you don't have to worry about as small cap value stocks really run and is it time to move to the large cap growth stocks, those decisions are done for you.

There are 2 types of pro-active investors, people who are interested in their investments have some knowledge of the market and are comfortable with making investment decisions at least at the asset class level. For them you can either provide either passive funds for people who want to make asset class decisions, I think equities are undervalued level versus bonds so I'm going to invest in equities and I don't really want to decide managers, we'll just buy an index fund. And then the more sophisticated pro-active investor who really understands the difference between active versus passive, understands manager styles, they can use the active funds that are provided. And for the very active investor,

many plans provide a brokerage window for those people who want to buy just about anything. The reality is that life cycle funds are probably best for 98% of your participant base, these are people who recognize they don't know anything about the stock market and those who think they know a lot about the stock market and who are wrong. So looking at a place where ultimately a lot of your participants should be invested.

On page 2, there are 2 broad categories of these sorts of packaged one decision sorts of investments. The first are target risk funds, these are what you have today. These are funds that are intended for people with a particular level of risk, conservative, moderate, aggressive and they adopt an asset allocation and asset mix that is appropriate for these people with this self declared level of volatility. The other which has become very popular and have developed a level of notoriety, are the target maturity funds. The problem with the target risk fund is they have a static asset allocation and if you think about the life cycle of a participant, when you are young and have a long time to retirement, you have the tremendous advantage of being able to not react to short term volatility in the market, you might be 5 or 6 cycles in the market away from retirement and therefore are able to take a much more aggressive position than someone who is closer to retirement for whom losses in the year or year before retirement are unrecoverable. If you lose 50% of your assets the year before you're going to retire, you don't have the time to recover those losses. If you are 30 years old and are not going to retire for 35 more years and you have a bad year or two, you can just wait for the market to recover and the market has always recovered. The target maturity funds work differently, they have a date associated with them which is generally believed or thought to be your retirement date. For example, somebody who is 60 today might invest in a 20/15 fund and a 20/15 fund has and always has the asset allocation is believed to be appropriate with somebody with that target horizon which means it becomes less and less aggressive, more and more conservative as you approach retirement, which makes this a true one decision portfolio. If you're going to use target risk funds and I'm talking over a person's life span so it's a very long time, when you're in your 20's and 30's, you ought to be very aggressive, when you're in your 40's you ought to be moderate, when you're in your 50's you ought to be relatively conservative, when you're in your 60's you ought to be very conservative because you simply don't have the time, that requires the participant to proactively adjust their risk tolerance as they move through life.

The other issue about target risk funds is the average participant doesn't really understand what the real risk of these plans is, which is not losing money in 2008, it's not having enough money to retire, it's called longevity risk. Longevity risk means simply you're going to live longer than your money lasts. If you look at most people's account balances, they will deplete those account balances much more rapidly than their life will expire. So the real risk is not what happens in 2008, or 2000, or 2015, the real risk is not accumulating enough wealth to have a satisfactory retirement. People tend to focus on, I could lose a lot of money in 1 year, you might make it back in the next 2 years and since you're not going to retire in the next 20 years, what difference does it make. They obsess with every single statement they get. One observation is people's time frame basically is however frequently they can get performance data. In the old days, years ago or 10 years ago, you got statements every quarter and that was your horizon, now you can get statements every day on the web, which means people freak out if they lose 2% in one day and start making foolish investment decisions. The target maturity funds are literally intended for the typical

participant to be the only thing they hold and literally you can buy it on day one and hold it all the way through retirement.

On page 3 we talk a little bit about participants, I talked about how most people are not financial planning experts and however good your communication is and I think your communication is excellent and that's reflected by the very high percentage of your assets that have been taken out of the realm of trying to play the market and into the realm of buying a risk fund that is suitable for somebody with that risk characteristic. Most people also don't understand the relationship between risk and return and our economic system for the long haul certainly and even most short periods, there's a trade off between risk and return. There are no investments for any period of time that can give you high returns with little risk, there is simply no such thing. The reality is if you want high returns, which is what you need if you can't save enough to build a pot of money at retirement that you could live on. If you're in a position where you could save 20% of your income over a 40 year working life span, you don't need to take any risk, because you could accumulate a pot of money, all you really need to do is insulate yourself from inflation. But the reality is most people can't save 20% of their income, most people don't save for 40 year working life span. So the reality is they're going to need to create wealth by taking investment risks and what they don't understand is given the longevity risk is the real risk and not volatility over the short term, they don't invest aggressively enough to create any real wealth, they become very conservative and if you look at how your money is allocated in the 401a Plan, then yes, a very attractive portion of it is invested in target risk funds, but 30% of the total is in the conservative fund and I would suggest that it's unlikely that your plan demographics are such that consèrvative is the appropriate fund for many of those participants. Basically it's going to be invested in a way that minimizes volatility but maximizes risk and again the risk is not having enough wealth created when you retire.

(Page 4) Many participants don't understand the critical importance of asset allocation, they obsess on the wrong thing, they constantly fuss about this fund or that fund when the reality is which fund is much less important than what your asset mix is. You want to have an asset mix that is efficient that maximizes the return for given level of risk, you want to provide diversification, you want to invest in a lot of different things, because at any point in time, one or another thing is going to be really out of favor and most people don't even understand how diversification works, the idea of correlation, the fact that asset classes don't move together, what asset classes are likely to move together. Unfortunately, many people buy whatever is the highest number lately, chasing returns which is a very hazardous enterprise because typically whatever has done well lately, when the market psychology changes, will do very poorly. So the best strategy and again we're not giving you personal advice, in one sense is to buy what's done the worst lately, because that's what is likely when the cycle changes, to do the best going forward. When you invest, what happened in the past is meaningless, you can't buy the past, that's not for sale, you can only buy the future. So you can make an argument to buy the worst performing asset class because when the psychology changes, that's the one that's going to do the best. If you buy the best asset class, you are likely buying at the top and will probably become despondent and sell at the bottom.

(Page 5) The whole idea of these life cycle funds be they target risk or they target horizon, is a one decision option because the vast majority of participants are constructing portfolios

that are unable to achieve their long term goals. That's not true with your group because the education efforts, have been very successful and it's very easy to judge how successful because if we accept the premise that a life cycle investment is better than the average person trying to construct a portfolio from the options that we provide, they just don't have the tools, the knowledge, the techniques, anything. The one decision is really the best approach for them.

Again, there are 2 types of funds, the first one that came out was the target risk fund, the idea of let's segregate the people who want a conservative portfolio, moderately aggressive, aggressive, however you want to characterize them. There are pros and cons of each, there has been a trend throughout the industry to move away from target risk towards target horizon and it will be interesting to see in light of what's happened in the last 2 years, to see if that trend changes. But the belief that people self assess their risk tolerance as being too conservative and that's the problem with the target risk fund, most people are unwilling to say, I'm 25 years old, I can tolerate a lot of risk, that's what's appropriate for me. Everybody wants to be conservative and conservative options just don't generate the return potential, the wealth return that you need.

Page 8 shows how different portfolios can be constructed. If we assume, looking at the asset classes that we've been provided here, money market or stable value is the most conservative, it has the least expected return and the lowest expected risk. Next would be the bond fund, which would have more expected return, but somewhat more risk. The next category in general would probably be large cap U.S. equities and then depending on how you want to look at it, small cap or international. As we look at the conservative, the conservative is predominantly in money market, it's going to produce a return modestly above inflation, it's going to have a modest positive real return. To aggressive which has got very little money in bonds and money market, a lot of money in domestic equities, a big chunk in small cap and a big chunk in international, that's an asset class that's going to exhibit a lot of volatility in short periods, this would not have been a pleasant place to be in 2008. The question is, if you look at it over 2008, you're probably going to make a bad decision. If you look at it over a 10 year period or 20 year period or a lifetime, the aggressive is going to create much more wealth. We would argue that they're probably mis-named, that conservative could be called low risk, low wealth creation and moderate risk and moderate wealth creation, high risk predictably high risk and high wealth creation, because these 2 go together. There is in our economic system a correlation between risk and return and if you want to make $3,000 a year contribution grow over a 40 year period to a million dollars, you're going to have to take high risks. If you have a 40 year horizon, you can take high risks, it doesn't matter to you what happened in 2008, because you're going to recover that, look at what we've seen so far in 2009. That statement (on the bottom) that high risk funds generate larger losses when viewed over short term horizons such as a year or 2, it takes that market cycle or even multiple cycles over a working lifetime for that conservative fund to produce reliably that higher wealth.

We've talked about target date funds, this has become a much more common approach. They tend to be offered in groups, they came out in decades, 2010, 2020, 2030, 2040, so forth. Because when you are at where we are today, 2009, there's a huge difference between what's appropriate for a 2010 retiree versus a 2020 retiree. They thought about it as we approached the decade boundary that maybe they should also have a 2015 so that

there's not such a big difference in the asset mixes between a 2010 which is 1 year from retirement and a 2020 which is 11 years from retirement, let's put them in the middle, the more common model now is the 2nd. The income fund is for somebody who is in retirement who has basically already retired and is past the accumulation phase and is now in the distribution phase of their retirement.

The reason these are appealing is they don't require any action at all by the participant. Again, if you are in the target risk fund, you need to every once in a while make sure you are in the appropriate place, you might start in the very aggressive, move to the moderately aggressive to the moderate, to the moderately conservative to the conservative. In a target horizon fund, these are all done for you and we illustrate that on page 11 and you can see that, for example, the income for the Retirement Fund is mostly bond and money market what you'd expect for being appropriate for an investor who's already retired, who's out of the accumulation phase. The 2010 looks a lot like the Retirement Fund, but it still has a little bit of international and a little bit bigger slice of small cap and you can see as you go out that horizon, out to the 2040, the 2040 is pure equity, it's pure risk assets. It's mostly large cap with small cap and as the calendar pages pass and we go from 2010 to 2020 to 2030 to 2040, by the time we're at 2040, you would be looking at the Retirement Fund. The rate at which the assets become more conservative as time passes is called the glide flow. As the calendar moves, the allocation changes automatically. The rate at which things move is called a glide path and you'll hear that phrase a lot because there has been a change in the thinking and perhaps an untimely change. If you look at what we depict here, this is probably the way funds looked 10 years ago, the assumption being in retirement, you would be predominantly low risk assets and somebody said, except if you retired at age 65, if you're a man you'll probably live another 12 years, if you're a woman, another 17 years, should you basically have nothing but bonds in cash if you're going to live potentially another 15-20 years.

So what's happened over time is the glide path has been adjusted so that in effect what we call here the 2010 looks like what we would be more the retirement vehicle and the 2020 would be what they suggest for the 2010, the theory being that you still need equities, risk assets, growth assets in retirement in order to create wealth to adjust for inflation, to deal with the rising cost of everything. Now what that meant was that asset mixes for very near term funds had a much higher allocation to equity, sometimes as much as 50% than most people actually thought about. Visit 2008, 2008 you invested that 2010 fund, you're 2 years away from retirement and all of a sudden you have a 25% loss because the half of the fund that's in equities is down 50% and this led to a lot of noise in Washington, hearings by the Department of Labor and the Securities Exchange Commission about the appropriateness of this glide path. Have funds become too aggressive. The funds all vary, T. Rowe Price's funds are relatively more aggressive, J.P. Morgan's funds are relatively less aggressive, Fidelity's are less aggressive. At the more aggressive end, there's equity in there if your age 85, which is probably a little bit problematic. Of course consultants have a cynic gene and the cynic in me would say, the fees for the equity pieces are larger than the fees for the fixed income pieces and the cash piece, so the purveyor of the target funds is making more money if the funds have a higher equity allocation. But the reality is this has caused a rethink about whether or not we've gone too far in that glide path, but that doesn't invalidate the concept, the question is do we have the dials in the right place.

I think we sent you a paper I wrote that was actually picked up in the press also questioning the glide path because of actual participant behavior. We got some data from J.P. Morgan that basically showed that the average participant takes out 20% of the money before retirement and depletes their entire account in 5 years. That clearly violates the assumptions of the long glide path. Basically the real world is that because people haven't saved enough and want to maintain the same standard of income, they deplete their account balances very rapidly, which means that they're just as exposed to short term market volatility as somebody who is very near retirement. Again, this doesn't invalidate the desirability of this kind of fund, because it avoids the fact that most people self assess their risk wrong, they are conservative when they shouldn't be, in some cases, they're risky when they shouldn't be and this basically is a true one decision. If it's run properly, if you're going to retire around 2030, the 2030 fund is just the perfect fund for you and maybe you could do better but the odds are against you.

(Page 12) The target date funds have got the Good Housekeeping seal of approval from Congress who in the Pension Protection Act of 2006 made them what are called qualified investment alternatives, which means a plan sponsor who makes them available as a default option, meaning if the participant does not make a designation where the money goes, the plan sponsor is indemnified against suits by the participants for inappropriate investments. Congress is very concerned about people making stupid decisions with their 401k plans. The reason is very simple, they're aware in the private sector most defined benefit plans have been terminated or closed, that most people are going to be retiring with basically social security and whatever 401k money they have because they haven't saved any money outside of those and have realistically been given the foolish investment decisions that most participants make, the baby boomers have no where near enough money to retire on anything like the lifestyle they'd like to maintain. If you look at the average account balance, it's pathetic, the average account balance would be depleted if you look at their last paycheck amount, suppose they're making $50,000 and they need 80% of their pre-retirement income to live on, that's $40,000, if they're account balance is $80,000, they will deplete their account in 2 years, then what. So the Government is scared to death that you're going to have a whole cohort of the population that's basically going to be living under passes and that's why they have given people safe harbors for investment education, they've given people safe harbors for managed accounts, they've given plan sponsors safe harbors for target risk funds because they're frantic to get more money invested and earned in these accounts. Or, this will collapse the Government, if basically the Government has to keep these people from literally destitute, the country goes bankrupt.

The target date funds are relatively new, they're growing very rapidly, it's very hard to assess their performance because they're relatively new, they have very little track record. We're use to looking at benchmarks, we want our large cap growth fund to outperform the Russell 1000 Growth, we want our international fund to outperform the EAFE Index. There is no real consensus about what the benchmark is for a target risk fund, what is the proper benchmark for a 2020 fund, because if you think about it, there are 2 variables, there is, what is your glide path, how much is invested in risk assets and how much is invested in stable assets and then how are those different components invested. So unlike asset classes where there is an index that provides some sort of guidance to who's doing well and who's doing poorly, there really is no passive market glide path. Some people believe you should have a high level of equities far into retirement other people suggest not. I think

there was a movement out further and now that movement is coming back. I don't think or nor should they have the glide path hit pure safe at retirement because people are going to live past retirement but if they're going to deplete their assets in 5 years, saying we have to give people protection for 20-25 years they're going to live is ridiculous, that's not realistic. So it's very difficult to say any particular risk fund is doing well or badly because you can say, well if the market is up, the T. Rowe Price funds are going to out perform the Vanguard funds because they all have, for each target date they have more equity and if the market's up they're going to do better and if the market's down they're going to do worse, what does that mean, who's better. So they're difficult really to benchmark, but they do have tremendous advantages to the participants. You have the option, as you might expect, between active and passive.

The active funds have active managers for each one of the roles within the structure. The passive funds are all passive, you're just getting a pure index performance, but with this changing asset allocation is a calendar and there's obviously particularly for the larger plan, a lot of thinking about what's the right way to do it. We've been helping larger clients who have the ability to create their own target date funds basically looking at customizing the asset allocation or the glide path to the participant characteristics. If it's a relatively highly paid participant base, the glide path is different than if it's not and if they have a defined benefit plan, the glide plan can be much more aggressive because they have assured income from the defined benefit plan.

We've done some research on what the asset mix would have to be to have a particular target replacement ratio. The replacement ratio is how much money you need to have of your pre-retirement income to maintain the same lifestyle that you had when you were working. If you were working, after you retire, you don't drive to work everyday, you don't have to have business clothes, there are expenses you don't have. The original thinking was, maybe the replacement ratio was 70% but the reality is it's probably more like 90% and most people want to live like they've lived before or better which is the reason they're depleting their funds. So we've done some work with some large plans to look at what the glide path would have to be to maintain a particular target replacement ratio so that we're not looking at just what is an abstract attractive portfolio for somebody that is age 60 but rather looking at it if the target replacement ratio is 80% for somebody who's age 60, what would the asset mix look like. But unfortunately these are really for funds that are larger than the Fund has.

One area that I want to mention because it's going to become more prominent is this difference between the defined contribution and the defined benefit plan and is there some way to bridge the gap. One option that's being considered is an annuity as an ongoing option in the plan where basically you have an annuity option and every paycheck you're retirement annuity grows a little bit. So if you allocate a portion of your investments to the annuity option, maybe every paycheck your retirement lifetime annuity grows by $3 a month or $10 a month, whatever the numbers to basically give you an assured income that you can't outlive because it's a life annuity, which is similar to what you have with the Defined Benefit Plan. Or, the opportunity to buy an annuity with a portion of your account balance at retirement, but on a kind of mass purchasing basis, if you go out and buy an immediate annuity at retirement now as an individual you get a very poor financial deal, but if a whole organization of people made that available, you might be able to get a more

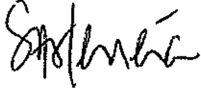
attractive deal and that would deal with longevity risk, your income would be whatever your assets could buy, but at least you wouldn't outlive it, you wouldn't have to worry about running out of money.

Ordinarily I would say your participants would be better off with target date funds. One of the issues with the ongoing annuity option is it's simple to do an immediate annuity on retirement because you know what the account balance is, you can just buy an annuity. A lot of people are interested in the annuity as an ongoing option but there are some administrative issues with that, because they are earning something of value that was only paid in the future, somebody is going to keep track of what these people are. If you have a participant who works for you between age 25 and 30
and they contribute to this annuity, they have earned an annuity of $100 a month for
life at age 65. Somebody is going to have to be able to find them at age 65 and you start to run into some administrative issues of, how do you make sure it's the same person, there are all sorts of interesting administrative issues. But what it does is it bridges the gap between those who have defined benefit plans who have an assured income for life and those who are going to have to live on very meager account balances. So as I was saying, ordinarily our view is target date funds and we've said so, target date funds are by far the most appropriate approach. This is simply an investment vehicle, but clearly if there is a mandate that the money must go into an age appropriate life cycle fund which is the default option right now for many plans that basically if you don't know what to do or if you don't react, if there's a fund closer, it gets mapped into an age appropriate, meaning there's a formula that looks at your probable retirement age based on normal retirement age and puts it there. With respect to the existing 401a Plan and the 457 Plan, given your very high 401a Plan, use of the target risk funds, I think to introduce the target date funds would be massively confusing. I think if you're looking at an alternative plan structure, that would be the way I would go if you're going to have a new supplemental plan. It's unusual to have both, you have one or the other and if you're a typical plan that has 10% utilization of target risk funds, moving people to the right target date fund would be simple, but if you have 65% of your money invested in the other way of doing it, I think you'd have mass confusion from my perspective. The target date funds are not an annuity, they're just another way of investing. You could attach an annuity to them.

Recommendation from Terry Dennison: I think given the relative ease that Great West talks about being able to do it, I recommend you make the change (from target risk to target date fund.) It doesn't require any legislative approval, we may have to look at the options that Great West can provide us in terms of what life cycle array there is, what are the glide path characteristics, what are the fees, but it doesn't sound like there's any great administrative burden, it doesn't sound like the education issue is something they are unfamiliar with, they strongly support it, we would strongly support it, I think it's the right way to go. Antolina Leon Guerrero: And all we would need from GreatWest is an analysis to see what it would look like. Board Chairman San Agustin: Would it be possible that you push that target date fund, we may not need legislation for the target date fund because of the hybrid plan. (Terry Dennison: The Hybrid Plan is completely different) Board Chairman San Agustin: we're talking about a benefit structure for the Fund. How successful this target date fund is will actually tie into whether or not this legislation is feasible or not. Why change it unless you're going to give them the option to go to either plan. Antonlina Leon Guerrero: I think as we look at the options for the hybrid plan, it's to find a way to

supplement what our members are going to be able to live on when they retire. We need to preserve the integrity of the current DC Plan, we can change the way we do it from target risk to target date, I think we can go ahead and do that, work on that while we study the options for the hybrid plan and present that to the Board separately because that's going to require legislation.

Respectfully submitted,



STEPHANIE A. HERRERA
Recording Secretary

Affirmed:

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Wilfred P. Leon Guerrero, Chairman