Quarter Ended 12/31/08 Performance Meetings
& Annual Manager Reviews
March 4, 5, & 6, 2009
Retirement Fund Conference Room

Friday, March 6, 2009

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
James Taylor, 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

Defined Benefit Plan: Pages 1 to 10
Defined Contribution Plan: Pages 11 to 14

Defined Contribution Plan

10:00am – 12:00pm DBPlan – Wrap Up/Other Items by Mercer

Securities Lending:
Terry Dennison: Everyone is pretty familiar with the format and the format is here in part to demonstrate the good Governance that the Board follows. What I think we have is a further discussion about the status of securities lending, what do we do about funding domestic small cap and do we want to give more money to the 2 REITs managers, Cornerstone and Security Capital, discussion of Hybrid DB/DC, infrastructure, and the Aurora fund. That's what I have in terms of additional agenda items. In a note that I got from Diana, she wants to talk about a letter from Robeco asking for a guideline change.

We've talked to you before about our views on securities lending and it's ironic that the recent difficulties in the market have particularly impacted portions of fixed income. We tend to think that if there are market problems, it tends to impact the more aggressive asset classes like stocks and to be sure, stocks have gone down, but there hasn't been the

surprising crisis that you had in some areas of fixed income. One area that is impacted and there are a number of areas that are impacted, is securities lending and on our recommendation after you moved your custodial contract to Northern Trust, you turned off or not actually start securities lending with Northern Trust, so I think the question was what is the update on that. Just to remind you how the process of how securities lending works, you own individual stocks with many of our managers, funds cannot be lent, but if for example one of your managers owns Microsoft, and it's not just equities, it's bonds, particularly treasury securities, and somebody wants to borrow that security temporarily and historically going back, people borrowed securities because they had sold something and contractually were required to deliver the stock and for some reason didn't have it. Often before the depository trust company, the securities weren't in what's called securities industry good form, they were the wrong denomination, you sold 1,000 shares and you only had 2,000 share certificates, so you couldn't do that because there's no way to get change, you had to send it back to the registrar or get 2,000 share certificates or you simply owned the stock but didn't have access to it for some reason. Lately the borrower's or securities have often been hedge funds, borrowed securities so they can go short. A hedge fund is going to short a stock, sell a stock they don't own anticipating the stock's going to go down and you're going to buy it back at a cheaper price which is how they make a profit. They need to be able to borrow the securities, so there's been a tremendous increase in the amount of securities lending demand. When a security is lent, it's fully collateralized and the collateral is generally cashed, so if a hedge fund wants to borrow a security, they have to deposit 102% or 105%, depending on the terms, of the value of the borrowed security, so you are fully protected. A lot of the concerns or identification of risk of securities has always been, what happens if the borrower can't return the stock and that's not what the problem has turned out to be, the problem is in the investment of that collateral. If it's 102% and it's marked to market every day, which means if the stock rises in value, becomes more valuable, they have pledged more collateral if the stock falls in value, they can draw the collateral out and a securities lending agent in this case, Northern Trust, manages that process for you. The economics are the money that is pledged is almost always cash, it can be treasury securities, is invested by the securities lending agent in an investment fund, called a collateral pool. The collateral pool takes the collateral cash and invests it and the income from that collateral pool is what provides the income to the securities lending program. When you do get a report saying you made $500,000 of securities lending, that's where the $500,000 came from, the investment of that collateral.

We need to look a little bit at the earnings because earnings are actually split 3 ways and this split is part of the reason this has become so troubled. The borrow of the securities, the people who are borrowing it and pledge collateral, get a rebate, they get part of the income and that rebate can be as much as 50% of the income. What's left is divided between the plan sponsor and the securities lending agent on a fixed proportion, it's usually 70% to the plan sponsor and 30% to the lending agent (Northern Trust) and that's how the lending agent gets paid to do this. Let's look at the conflicts that are inherent in this transaction, because the lending agent gets 30% of the income after the rebate, they would like to get as much money as possible so they want to kind of herd you if they can, into more and more aggressive securities lending pools, pools that make more money for them. For a long time people didn't really pay much attention to the risks in the collateral pool and as interest rates fell, there wasn't much money in the collateral pools. Of course the

bank is doing a lot of stuff so what was happening was they (Northern Trust) were doing a lot of work to manage the pool, they were reclaiming securities, collecting dividends, all this stuff and they're only compensation was their share didn't come from a collateral pool so they tended to become more aggressive. Where previously the collateral pool might be short term treasuries and agencies and A1P1 commercial paper, that was no longer producing enough income, they wanted more money. Some of the securities lending agents started to develop more aggressive collateral pools, collateral pools that invested in longer duration and the longer duration meant that if rates rose, the value of the collateral pool would decline because that's they way bonds work and Also took more risk, also collateral pools historically had all over night money because in theory, a huge amount of securities could be returned in which case you are contractually obligated to return the collateral. If you remember yield curve, over night money is almost always the lowest interest rate, so Northern Trust which probably reached out further than anybody and got in more trouble than anybody, also launched a series of collateral pools that were not all over night money, they were called the Step Program. The Step Programs had a portion of over night money, but invested in other things to get further up the yield curve and make a little bit more money. Now enter some of the recent unpleasantness, what happened is some of this money was invested in Lehman Brothers, being a securities brokerage firm, has always got a lot of cash needs, so they invested in Lehman Brothers paper. Of course when they became bankrupt, that became worthless, so now the collateral pool which the bank is holding on your behalf and must be repaid to the borrower when they return the securities is no longer worth the 102%, maybe it's worth 90cents on the dollar. If you read carefully your securities lending agreement, if the shortage in the collateral pool and the securities are returned, they just take the money out of your account and you have no control over it at all. So first we had the damage to the collateral pool, some of them for Northern Trust were also investing in some other sorts of toxic securities, so what some organizations have ended up with are what are called zombie loans, they're loans that you have to keep out because as long as you can keep them out on loan, you don't have to pay the collateral back. What happens of course, the securities markets are not a friendly place, the borrowers are aware of these zombie loans, so they start to demand a larger and larger share of the income, remember, they're getting a portion of the income before the split. So they basically say, we're going to return your securities unless you give us instead of a 50% rebate, an 80% rebate, because in a sense, they're holding you up, they're perfectly, legally holding you up, because they have you in a very nasty place. If they say, you're not paying us enough rebate, here are your securities back, I want my money back, you now have to recognize this gigantic loss and there's now a growing amount of this, and it's not just Northern Trust, it's State Street, Bank of New York, JP Morgan Chase, all have this problem although it appears to be more severe at Northern Trust.

There is a local fund that happens to be local to Northern Trust's head quarters in Chicago, that has had to pay out several hundred million dollars to deal with this problem, they were a bigger fund than you and had more on loan. What's happening now is the economics of this are becoming less attractive, because these borrowers of these zombie loans are basically saying they want all the income. You want them to keep your security and they know they got you so now they're demanding a larger rebate, so what this has done is completely shoot the finances of the securities lending business. The other concern and it's not just a concern with Northern Trust, but it's a concern with respect to all of these

custodians, they have very large securities lending portfolios, relative to the size of their capital, they have hedge fund like leverage. If you look at the actual corporate capital of any one of these banks, for example, State Street Bank, they have about $7billion worth of capital. Well, they have about $500billion worth of loans outstanding. So right now if one of these organizations got in trouble, you're exposure would only be securities transactions actually being settled, you're assets are safe, they're segregated from the assets and liabilities of the bank. There is a point, a very short period of time where you're exposed, because the trust account that protects your securities in general, can't settle transactions, the transactions are settled on the bank's balance sheets. There was an article that Northern Trust is returning the Tarp money it got, perhaps they don't want to be bound by the restrictions, US Bancorp was the other bank that was returning money, that was in the news too, but the reality is that you are still exposed with any custodian if a manager is selling or buying a security, because there's a short period of time, usually intra-day, where the value of your security is actually on the bank's balance sheet and you are simply an unsecured creditor. Now your managers are not heavy traders so the likely hood of this happening is low, but we're still edgy about securities lending in general. It used to be seen as a risk-less free money, whatever happened, you're fully collateralized. What's been discovered is it's not risk-less, it's not free money. One of the issues that's going to surface is, some amount of securities lending income was factored into Northern or any of the other bidders fee proposal, so right now, they're a little short, because they're not getting the securities lending income that they were expecting. Now they're going to become more and more hostile about this because they're spending all this money doing your recording keeping and trading and reporting and providing other services to you and they're probably only getting 80% of what they thought they were going to get, but as a Board, that's not your problem. Antolina Leon Guerrero: What you're saying is the financial benefits of securities lending has sort of disappeared because of the nature of the market, they weren't going to make the money anyway. Rosalia Bordallo: That occurred only after negotiations of the contract, the situation exploded after we negotiated. At the time of negotiations and the signing of the contract, we were fine, they were fine. I think what saved us was basically when they said to us, the pool that we wanted to use, they couldn't give it to us, could we decide on another pool, which made us basically stop and say, maybe we should look at, and then the market exploded. So it just was a situation that was perfect timing for us, we're not participating in it. Investment Committee Chairman Leon Guerrero: Let's personalize this, we're the owner of a stock and you have a borrower and I guess this is the broker, we own the stock, the broker comes in deals and somehow they make their money that way, using our assets. Board Chairman San Agustin: They put up a collateral which is an investment. Terry Dennison: The collateral is invested by Northern Trust in one of their collateral pools. Investment Committee Chairman Leon Guerrero: But you could lose that collateral by action that is out of your hands. Terry Dennison: What's happened is, what we've seen in this whole business, is a lot of things that were thought to be risk-less have turned out not to be. Just to illustrate another circumstance that is happening and we look and we don't see an issue with yours, in the DB Plan you have a stable value fund. The stable value is kind of a little complicated fund, at the bottom of the stable value fund is a bond portfolio, and the bond portfolio earns income and the manager of the pool takes some of the income to pay for the management, some of the income goes to what is called the wrap provider, effectively the insurance company who is insuring that participants can take money in and out at book value regardless of what's happened to the bond portfolio

and the rest is provided to participants is a crediting rate and for years they've just run along smoothly. What's happened now is in these bond portfolios that are backing the stable value funds, they're losses in those too. One of the things we look at every quarter with our clients funds is what is the ratio between the market value, which is the promises to the participants, the participants balance, and the actual underlying value of the bond portfolio, because the insurance companies that are providing the wrap, which is the guarantee for participant direct trades of par, will have circuit breakers built into their contract. Basically if the ratio of market to book falls to a low level, they will withdraw, they're perfectly entitled to say, they're unprotected, they will no longer honor the wrap agreement. There are clients and we have a client that a portion of their bond portfolio was managed by a stable value manager, was invested in Lehman paper and you have what's called the last person and that's the politically correct way to say it, problem with this. If the bond portfolio is worth 90cents on the dollar and you as a participant take out your dollar, eventually they're going to run out of money before they run out of people. So the only equitable way to deal with this is basically have the stable version of breaking a buck, everybody gets 90cents on the dollar, because otherwise you have a fairness issue. The people who are aware of this can take advantage of the people who aren't, because they can do a participant directed transaction and take their money out on 100cents on the dollar further depleting the amount of the assets that are available to the other participants. Again this is not a problem with your fund, but we're monitoring it. You can say, why doesn't the Board basically announce there's a problem, but the contracts are void if it is an employer initiated transaction, if you start a run for the door, you own the problem.

One of the things that's been different about this recession, one of the problems with this is a whole bunch of things that use to be okay have now gone haywire and it's been haywire in the last place you look. Who would have thought the problems would be with stable value, money market funds, securities lending pools, everyone was focusing on the risk of securities having the stock go up a lot and now the stock's worth $110 and you only have $102 in the collateral, you're exposed to an $8 loss. Nobody ever thought about what happens to the collateral if the pool goes bad and of course what prompted this is largely the Lehman bankruptcy because as the Treasury discovered to their pain, Lehman was plugged in all over the economy, I think if they could have rolled back the clock, they would have bailed out Lehman because the mess this has created is enormous. Back to the question at hand, we would still recommend you continue to avoid securities lending until we get some sort of clarity about what's going on here. You wouldn't make much money and you would be subject to all the risks here and I recognize money is short and I'm not ignoring the fact that you would be probably giving up something, but what you are avoiding is an unknown probability and unknown magnitude or risk and it's very hard to suggest that somebody subject themselves to a potentially large, potentially possible risk for a diminishing amount of income, it's just not worth it. So that's the state of securities lending.

Funding of Managers:
We have 3 managers that are either unfunded or only partially funded. The REITs, we funded them at 25% of their intended level, partially so we had some exposure in that market. Clearly, the real estate business is suffering dramatically and you heard yesterday all of the issues regarding the commercial mortgage backed securities, while it is a different

kind of investment, it is clearly reflecting the issues that exist in the real estate market. The real estate market obviously involves significant long term capital investments at the property level in exchange for a flow of revenue rents. The value of the properties is tied to the level of the rent through something called a capitalization ratio. Just think about if you had rental property, you own an apartment, the value of that is a combination of its physical replacement cost plus an element of future rents. Well 2 things are happening, one with inflation at very low levels, the replacement cost of buildings is no longer rising and of course buildings are subject, unlike a share of stock, to physical deteriorations. So real estate unlike a bond or a stock if left without maintenance rapidly loses value. The other major factors are the rents. On the mainland if you go into a mall, you could be the only person there, you're seeing a tremendous number of empty stores, the stores that are there are having sales at such a level, they must be selling things at a loss, the reality is you're seeing people behind in their rent, another factor in commercial real estate is usually a portion of the rent is related to sales, the landlord might get 4-6, maybe 8% of sales, so all around, it's a bad deal to own property. There are similar problems in the hospitality business, hotels are really struggling at this point, they have large fixed costs and people just aren't renting rooms now, travel is way down. The office market is shrinking because people are reducing their work, they're not taking up any rent, there's not a lot of new organizations being formed, so basically real estate is in a bad way. I'm not uncomfortable with the very small amount of money, and certainly at the total fund level we have 2 REITs, because again, the situation could change. It's nice to have our toe in the water, but I would be disinclined to add more money right now. So, my recommendation would be to remain status quo, we have a small exposure, it allows us to monitor the managers and monitor the asset classes in the reports. Our valuations still indicate that the REITs are still over valued from a traditional basis, they have fallen a great deal. This is not an asset class that is giving you any diversification benefit, they've crashed and burned like every other security has, which is by far the best asset class we have, it's not losing money, it's making money. The other unfunded mandate, totally unfunded mandate is domestic small cap and in this case the money is parked and we try to park the money in something like it. so the REITs which are more fixed income like are parked in fixed income, but the small cap is parked in large cap which is the closest asset class we have for it. You had identified a manager back 2 years ago based on a search that was 3 years old, THB, in the meantime, we have re-looked at THB on a routine basis and have lowered it's rating from a B+ to a B and have expressed some concerns about the looseness of their investment process and formally the research note and the recommendation rating shows we would not recommend any client use them. At this point we would be very uncomfortable with proceeding with funding. Now, because the work the Board did to influence the legislature to grant us the ability to use exchange traded funds, we can have exposure to this asset class now without having to hire a manager. We can use exchange traded funds which track the Russell 2000 Index, which is the small cap core index, so we can have anywhere from .01% to the full 10% in this asset class.

As I said yesterday, one of the concerns of small cap in a difficult economic environment, these are called smaller organizations by definition, smaller organizations are more frail in terms of their financing, they're probably instead of having a couple of credit banks, maybe have one. They may not be as highly rated for commercial paper, they're more subject to be negatively impacted by the availability of credit and the price of credit and they're often

suppliers to larger companies. There's been much talk of the concern with the auto companies and there was more noise today, the auditor for General Motors basically said, they don't believe it's a going concern and that will probably trigger debt that basically required the company being judged by it's auditor to be a growing concern. So the General Motors bankruptcy issue is back, if you watch CNBC, they talk about it about every 5 minutes. If you think about the supply chain for the auto industry, and this is one of the political reasons for perhaps continuing to support them although at this point, they're becoming just a constant drain on the Government, because they're going to spend tens of billions of dollars fixing up that mess, the problem is the supply chain is a lot of small companies. So if they do go bankrupt, what's going to happen to the company that makes the steering wheels, what's going to happen to the company that makes the hubcaps. At this point because of the concerns about credit, both it's cost and availability and the fact that banks have severely tightened credit standards, we certainly would not be comfortable with fully funding the 10% allocation to small cap. Also on a valuation basis, while it's fallen a lot, it's probably fairly valued, so I think there's probably further declines. We would not object if we did what we effectively did with the real estate, where we just took a small position so that we have our toe in the water, we would strongly recommend that position be done by ETFs. This is in effect why we fought that legislation, because what it does is it frees the Board of the necessity of going through the whole procurement process which has proved to be at least time consuming. It becomes so time consuming that often by the time we're done, the business case for particular managers has changed, but at this point, we would really raise an issue with you if you wanted to fund THB, but I think a 2.5% allocation to ETFs, one, it would use the authority, and having asked the Legislature for permission to do something, it might be advantageous politically to use it. This is exactly what we had in mind. As far as using ETFs, this is exactly why we fought the legislation, because what it allow us to do is establish a position in a market space without having to go through all the grief of the manager process.

Investment Committee Chairman Leon Guerrero: In the event the economy starts to turn around, this sector is probably going to be the one that's going to go first. Terry Dennison: It's likely to have the largest gain, if only because it's had the largest decline. If you remember DFA's discussion 2 days ago, they talked about the small cap effect, basically what they showed you is any spectrum of the market you want to look at they break it down, the top 10%, then the next 10%, then the next and what they found that they illustrated in their report, that it's the small cap stocks that over time tend to do the best. This is not just here whimsically, it's here for a purpose, but again, tactically, if the economy continues to go down hill, the market had a dreadful day today, so whatever goodness we had yesterday is long gone. We're not at the point where's there tends to be more good news than bad news, it just now tends to be more bad news. So at this point I feel that ETFs are the way to implement, if you wanted to, I would be comfortable saying, you're not ready yet, or a small 2.5% or 25% of the total target allocation, either way, I would not be uncomfortable whatever way you came down on it. I would have a problem if you wanted to go above 25% because I do have concern about this whole issue of the relative weakness of their financial structure, I do have concern that they're often in the supply chain for large organizations that are often struggling. On the other hand, if we do have a turn around, it could be up quite smartly, but this is one where I really don't have a

strong view, zero is fine, up to 25% of the target is fine, above that, you're too early, that I would have trouble with. (The Committee recommended 10% of the target allocation)

Infrastructure Investment:
The next thing on the list, Dr. Leon Guerrero asked me to follow up on the presentation we made the last time on infrastructure as an investment. He asked, given the buildup on the island and the likelihood of substantial population increasing, the concern is expressed by the Government of Guam that the island has taken in people from affiliated islands and are there opportunities for the plan to do infrastructure investments and being mindful of the liquidity issues I raised yesterday and traditional infrastructure investments are very long term and very limited liquidity, but whether or not there are opportunities on the island to make infrastructure investments where we have more control over the duration of the investment. Traditional infrastructure investments can be as long as 40 years, if you are buying the rights to collect tolls or collect parking fees or transport water or do any of these other functions, it's only economic for the seller of that right. Basically they're trying to turn a stream of money into the future into money today so they want to make it as long as possible. The problem is, first of all, each individual investment here has to be analyzed, there's no general discussion. Clearly there are opportunities to invest in infrastructure, I don't know whether the Government of Guam has any infrastructure that has any really reliable stream of income.

Investment Committee Chairman Leon Guerrero: I'd like to position the Fund to be able to participate in infrastructure investment and that's the most important thing. A specific project is something we're going to have to discuss when it comes out. Terry Dennison: It would be most beneficial if the guarantor or the source of the income was not the Government of Guam. Investment Committee Chairman Leon Guerrero: We keep talking about this buildup and I think we're about the only entity on this island that has money to invest and we're not preparing ourselves. Gerry Cruz: I think it's a good point, but we just don't know enough about it yet, there's just been a lot of speculation. There's a forum in April that will shed some light on what the military needs are. Rosalia Bordallo: Currently your water system has to be upgraded, irregardless the military wants to come in or not, the water system must be upgraded and now they're been told that their sewer plant has to be upgraded to the tune of $100million and that's a revenue agency. There are no financing options, and you can go and say, we will finance it and at the rates, because the rates will have to go up, this is our cut on it. They haven't looked at financing because it's going to be difficult. Investment Committee Chairman Leon Guerrero: The first question is can we do it. Terry Dennison: That's a legal question and I can't provide you with advice. Dr. Leon Guerrero: We should position the Fund to be able to invest in direct investments. Board Chairman San Agustin: Let's say the Government issued a GPA bond, you can buy the bond, there's nothing prohibiting that, the existing law doesn't allow us to directly invest on a building for rent, like a banking situation, I think our law allows us to buy the paper to support the investment. Terry Dennison: Typically the way these things are structured is through a limited partnership deal which may get around this issue because typically what they set up is a limited partnership, an LLP that either owns the actual thing or what they own is the rights to the revenue. Typically what our clients have done with direct real estate is set up a title holding corporation in which they own 100% of the stock so the building in this case or the rights to the revenue would be owned by a separate corporation,

partially to insulate the pension fund legally from claims against the owners of the building. Investment Committee Chairman Leon Guerrero: My interest on this is I would like to see the Fund positioned in a way to participate in that kind of investment. Board Chairman San Agustin: We can explore it. James Taylor: I hear the Chairman reading the law saying we don't have the ability to do that, but we can't do it directly, we can do it indirectly, so we would need to see a proposal. Terry Dennison:. I doubt that your existing investment managers would be willing to participate in a deal like this.

Robeco Request For Guideline Waiver:
Robeco which is one of your equity managers, is asking for a variance from the guidelines. The guidelines presently limit them to holding no more than 5% of the portfolios market value or the security of any one issue. The problem is at various times the few largest securities in the index represent more than 5%, for example Chevron Texaco is 6% of the index, they're not permitted to hold at index weight, which means that if they are neutral about it or positive towards it, they really can't produce a bet for it. They're proposing to limiting the investments to the greater of 5% of the market value portfolio or that index weight plus the weight of that issue plus a full percent, so if Chevron Texaco is 6% of the index, they could hold up to 7% which means they could express a positive view. This is a very routine action, certainly it has our support and frankly, a 1% margin above is smaller than most people ask for, most people want to have 2, so we would recommend approval of this. Gerry Cruz: I'm just curious, we're seeing a lot more of these coming on our desk, is there a reason? Terry Dennison: What's happened is with the tremendous rise in oil prices, the large integrated oil companies have become significant components of the industries.

Again Chevron Texaco is the largest component, so it depends a lot on what's going on in the market. We ran into this problem with the tech stocks back in 1999 with a lot of clients where some of the most attractive beneficiaries of the tech bubble became very large proportions of the index and they absolutely need to be able to hold the index weight because otherwise you're forcing them to basically make a bet against an index component and it's in your interest if they like a particular stock to be able to make a positive bet on that stock so that's why the margin of 1%. My guess is if we again get a concentration of waiting in the index of a relatively few number of stocks, we're going to have to be able to hold that. Right now at some point here, their compliance people are going to say, we're being forced to make a bet against the largest stock in the index and they might say, we as a matter of policy can't be dictated to what we hold. Right now if they're limited to 5 and the index is 6, they are forced to be under weighted in a security, so at a minimum we need to be able to allow them to hold index weight and we're hurting ourselves if we don't allow them to over weight an index name to some degree. Yet again as I said, the 1% margin is actually smaller than what we typically see, I think 1% is very reasonable. Did you enter this problem in the late 90's? Rosalia Bordallo: The managers knew how strict it was, it wasn't something they were fighting against, so it was never an issue. Gerry Cruz: Still what drove the market in the late 90's were the tech stocks. Terry Dennison: They couldn't buy it anyway because of the other provisions. Maybe this is the 1st time this has actually risen, but it's a reasonable request, denying it is unreasonable. It's not identified to name, the next time somebody is over the index, it could be a different company. Right now it's Chevron Texaco mostly because of the large cap of the energy company, next time it will be

somebody else. One of the advantages of having managers that truly are diversified by style, is right now this is more of a value stock, it's not something the growth managers would tend to hold. Because you have a true diversity now in investment styles, it's unlikely they would all focus on the same name for style reasons. Gerry Cruz: We just have to begin to pay attention to it, where as in the past it wasn't an issue, we just have to watch it. (A motion was made by Committee Member Cruz, seconded by Committee Chairman Leon Guerrero to recommend to the Board to approve Robeco's request.

Investment Committee Leon Guerrero: Terry, the other day you were mentioning spending more time in the bay area, does that mean you will have less time for us? Terry Dennison: No, I only have a few clients now because of my responsibility as Director of Consulting, and when I'm not working on client work or when I'm not here, I'm working in Los Angeles, but I'm probably going to spend much of this in San Francisco, it probably won't affect you at all.

Defined Contribution Plan

Hybrid Plan:

The next item on the agenda is a discussion we were asked to hold on hybrid retirement programs. In your package there are 2 documents, one is a one page from a website that provides high level, entry level information on a lot of issues and it just discusses what a hybrid plan is and how it differs from a 401k plan or a traditional defined benefit plan. Behind it was an article we found from a Government Financial Officers Association that talks about hybrid retirement plans in the context of public funds. There's a lot of information out there about hybrid plans that is more oriented toward the corporate market. Also clipped to your package is an email that I sent Diana, it's a discussion from Bloomberg, basically it's a long series of horror stories and how these horror stories came to pass. Back to the hybrid plans, they're a blend between defined benefit plans and defined contribution plans. To refresh everyone's memory, a defined contribution plan like your 401k plan, allows participants to set aside a portion of their income and control their investments. The value of your account is based entirely on how much money you put in and your skill at being an investor. We've commented in the past that the average account holder, the amount that non DB plan participants have in the 401k plan is very low. If you look at the 40-50 year old age group, they have $50,000, which is not much to live on. DB plans which is similar to you Defined Benefit Plan, basically you accrue a benefit by years of service and contribution and you are promised that benefit and it's the responsibility of the pension plan to invest the capital so that these promises can be met. The degree to which you have assets to meet the promises is what the funding ratio is. Hybrid plans developed because of 2 concerns, defined benefit plans become very expensive, contributions become large, and much of the push towards hybrid plans came from corporations who felt that they could no longer really afford the cost of contributions, they are beneficial to the participants in that they know what their promised benefit is.

The other type of plan the DC Plan, the concern there is called longevity risk, which is basically outliving your money. Because you're not promised a fixed benefit monthly, you have to budget how much of your capital you're going to take each year. If you take a lot to maintain a lifestyle you had when you were working, you will rapidly deplete your balance. It also requires that you make thoughtful investments, but more importantly, it also requires that you make substantial contributions. Most people are in trouble and trouble beyond recovery, because they didn't' start to save early enough and they didn't start to save enough. Your principal determinant of your account balance, not is are you a clever investor, but rather how much money you put in and most people don't put enough money in, when they're young, they're raising a family, they have expenses. One of the advantages of starting early is compound interest, so what happens is if you wait til the kids have gone to school and left, there's not enough time left for compound interest to create the wealth you need. The other concern with DC plans is the participant has all the investment risk and it is a risk that the typical person is ill-suited to deal with, the average person is not a wise investor. As I mentioned yesterday, they worry about the wrong risks, they worry about the risk of losing money in the short term, while the real risk is not having enough money in the long term. That's another reason why a lot of DB plans have been terminated and people moved into DC plans to get the investment risk out of the employers hands into the hands of the participants and that's why there's a common belief that the DB plans are

much better for participants. So the idea was to come up with a plan that had some DB like characteristics and of course the one irreplaceable characteristic is a known amount of money for life and that's the advantage of the DB plan, if you live a long time, you will collect much more of your contribution and if you live a short period of time, that the actuarials call an actuarial gain. There's a discussion in here about how these work, most of them involve what is called an account balance. If you look at the Government Financials Association on the bottom of the 2nd page, it talks about the most common hybrid plans. Both of them involve a balance, the cash balance plan basically works a little bit like a DC plan in that the employer sets aside a fixed percentage of the employers salary every period and then the balance earns an interest rate, so it's very predictable for the plan sponsor, they know what they're paying their employees, they can multiply that out, the money is invested, you still have all these investment decisions because you are now controlling the investments, it is no longer employee choice, their sole investment is in your cash balance plan. So we don't have all the related DC issues, but when you retire, you get your balance, you can either take it or you can buy an annuity and the annuity would give you income for life, the problem is it's probably no where the income you can live on, but that's a characteristic of it. You can adjust the earnings rate if you have a good performance and you are earning a lot more than the crediting rate you've promised, you might raise the crediting rate. You're still on the hook for making benefit payments, because you're still managing this pool of money. The pension equity is similar in that there's no account balance that is accrued during your working lifetime, you do a calculation similar to what you do with a defined benefit plan in terms of calculating the benefit, but it's not a benefit, it's a chunk of money. So when you retire, they look at what your income has been and your years of service and there's a formula that calculates what your benefit balance would be and then you get the choice of either taking it out in cash or having some sort of periodic payment or buying an annuity.

One of the questions I need to ask at this point is this simply a curiosity, what are you trying to accomplish with it? Board Chairman San Agustin: We're looking at the DC Plan as it is now, either to supplement it, but we know that the DC Plan right now, we're developing a welfare case of people that's why we can't depend on the DC itself. Like you said, they are not professionals at investing and they don't even know how they're investing their money, so a lot of them are concerned that when they're ready to retire, they can't. Terry Dennison: The issue clearly is with a hybrid plan, puts the plan sponsor, the Government of Guam and it's affiliates in a position to make a meaningful contribution? James Taylor: My concern is are we doing something more that will provide an adequate plan to the DC Plan and what will it take to do that. What are we currently doing, we say it's not enough, I want to see some harder facts on that and I think it might not be enough and the other part is, what would it take to do right by the DC Plan members and I don't want to create a new poverty class. Terry Dennison: When people speak about this, they use a term called replacement ratio and it's a subject of some discussion to how much money do you need in a post retirement world to live, the theory being that you maintain the same lifestyle and the theory being that you don't have work related expenses. So ironically, the replacement ratio here might be higher than it would be in a place like New York. Like in New York, you're not paying a $200/month train ticket, you are not having to wear suits and have them dry cleaned and so forth. The cost of living in New York is higher but you might need in a post retirement world to maintain the same lifestyle as you have

when you're working, because your work related expenses are not a significant portion of your income. If you wanted to approach it scientifically and of course you're not doing it for every individual, you'd be doing it for classes of people, maybe you'll look at what the income is for a certain group and look what their account balances are for the people who are not under the DB Plan, look at their balances and you could basically figure out what they're income would be. The way you would do it is, what could you buy for an immediate annuity upon your retirement. If you had an account balance of $50,000, you could buy an immediate annuity that would pay you $200/month for life and you have to ask yourself how does that income coming from that immediate annuity relate to what they were making previously and what you're going to find is they're going to end up with about 20% as much money as they had where a reasonable replacement ratio might be more like 80%. The ones that are DC participants, if you look at the 40-50 age group, what do they have in terms of average balance, what is they're average compensation, it would give you a broad sense of, are they going to have 20% of the needed money or 80% of the needed money. Board Chairman San Agustin: Is it possible to buy a lifetime annuity? Terry Dennison: Yes, there are what are called immediate annuities, basically it's different from a deferred annuity. An immediately annuity is basically, you go to an insurance company and you say you have this pot of money and what could you buy with that money and you can get all the usual terms, you can effectively get all the payoff options you may provide with the DB Plan. One of the things that are happening in the DC market is that people are really beginning to focus on its longevity risk. If you walk up to an insurance agent, you get a very bad deal, the insurance company gives you a fairly low level for your contribution and what's happened now is that organizations are recognized and are now making available sort of on a buying cooperative basis, getting more institutionally priced annuities, where as you may go as an entity to an insurance company and say, you're going to be offering this and what kind of deal could they provide because there are 6,000 people in the plan, so your selling costs are less, your administration costs are less, you get a better deal.

There are options that you can embed in your 401k plan that provide you an annuity. Basically you invest in this option and every pay period that you're in the option, you accrue a small lifetime benefit and they function just like any other option. So if you're making $100 a pay period contribution and you have 50% of your contribution going to this option, maybe every pay period you buy a dollars worth of lifetime income and you can move in or out and whatever you've earned is a lifetime income. They're relatively new and I think if you're going to do this, I would definitely see if you could do a deal with an insurance company to offer better pricing. That's one way to deal with the longevity option and you could effectively back out by just using a financial calculator, what is the benefit of an immediate annuity that you could buy for X dollars. It's very interest rate sensitive and with rates as low as they are, annuities are going to be really expensive. If interest rates go up, they will be cheaper because in effect the discounted value of the present value of the future benefits becomes less because of higher interest. One question is to really opine on, "is this just making the employees perception of their benefits so complicated that nobody can understand it and is there an option on a voluntary basis to roll your existing 401k balance into this plan just so that you don't have so many plans." You would actually have 3 different plans for people who are DB, DC and now hybrid qualified. I think it would be awkward and probably not legal to basically require people to roll their DC balances into this. But clearly starting from zero dollars, it's sort of a disincentive to play, if you could

roll your existing balance into the hybrid plan, basically what they would do is turn over their balance to the Board as their contribution, their account would be credited the amount they put in and it would be a 2nd pool of money now similar to the DB Plan and it would be the responsibility of the Board to run. I think that would ease the transition and make it a little less complicated for participants to figure out what it is they're going to do. The other thing you'd have to run into is if the hybrid plan is tax qualified, you would have to very carefully manage the pre-tax contribution limits, they're called 415 limits, because now you would have 2 tax qualified plans and there are limits imposed by the IRS about how much money you could put into these plans and you'd have to make sure through your payroll system that you couldn't exceed the pre-tax contribution limits into these plans. It's just one more thing to think about.

The Black Rock Aurora Fund will be discussed during the Board Meeting on March 7, 2009.

Respectfully submitted,

STEPHANIE A. HERRERA
Recording Secretary

Affirmed:

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Wilfred P. Leon Guerrero, Chairman