

**INVESTMENT ADVISORY COUNCIL
WEDNESDAY, JANUARY 12, 2005**

MEETING NO. 322

Members present:

Michael Freeman
David (Duke) Himmelreich
James Larkin
William Murray
Denise L. Nappier, Treasurer
Sharon Palmer
Clarence (Dick) L. Roberts, Jr., Chairman
Carol Thomas
Peter Thor

Absent:

Representative for Robert L. Genuario
Reginald Martin
David Roth

Others present:

Howard G. Rifkin, Deputy Treasurer
Susan B. Sweeney, Chief Investment Officer
Robyn Belek, Deputy Director of Communications
Patricia DeMaras, Associate Counsel
Gary Draghi, Principal Investment Officer
Greg Franklin, Assistant Treasurer-Investments
Bernard Kavaler, Director of Communication
Catherine E. LaMarr, General Counsel
Meredith Miller, Assistant Treasurer-Policy
David Scopelliti, Principal Investment Officer
Judy Balich, Executive Secretary
Sarah Carter, Administrative Assistant

Guests:

Raymond Clarke, Teachers' Retirement Board
Sean Quigley, State Street Corp.
Cynthia Steer, CRA RogersCasey
Raudline Etienne, CRA RogersCasey
Bradley Atkins, Franklin Park, LLC
Vonda Brunsting, Service Employees International Union
Rebecca Hanson, Service Employees International Union
Harvey Kelly, Leumas Advisors
Robyn Kaplan-Cho, Connecticut Education Association

Chairman Dick Roberts called the meeting to order at 10:40 A.M.

Chairman Roberts shared a “Thank You” note from Henry Parker with the group.

Approval of Minutes

Chairman Roberts asked for comments on the Minutes of the December 8, 2004 Investment Advisory Council (“IAC”) Meeting. There being no comments, **a motion was made by James Larkin, seconded by Carol Thomas, that the Minutes of the December 8, 2004 IAC meeting be accepted as drafted. The motion was passed unanimously.**

Opening Comments by the Treasurer

Treasurer Denise Nappier reported that the Office of the Treasurer (“OTT”) cleared another hurdle as lead plaintiff in the case against JDS Uniphase, which is a class action securities fraud case. She said that the defendant tried to have the case dismissed, but recently the judge ruled that there is merit to the case and it will go to court. Catherine LaMarr, General Counsel, gave some background information on the case, explaining that Treasurer Nappier’s campaign to encourage JDS employees to come forward is the reason that the judge ruled that the case did have merit.

Treasurer Nappier reported on another recent victory concerning CRPTF’s Walt Disney shareholder resolution to separate the positions of Chairman and CEO. She said the company agreed to adopt a policy to separate these positions and that as a result, she withdrew the resolution.

Treasurer Nappier said that there would be a Watch List presentation today triggered by last month’s discussion about the investment manager monitoring procedures. She said the report would include the list of managers on the watch list and how those managers are monitored.

Treasurer Nappier reported that she is considering appointing Fairview Capital, CRPTF’s venture capital fund-of-funds manager of Constitution Fund I, to manage a successor fund, and that they will be presenting before the IAC today. In addition, she said that CRPTF’s private equity consultant, Franklin Park will present a summary of their due diligence report on Fairview and the merits of establishing Constitution II.

Treasurer Nappier informed the IAC that the quarterly update on CRPTF Cash Flow would be tabled until next week, so that the IAC would have an opportunity to review the report that was just distributed today. She then commented on the significant positive cash position when compared to earlier projections and attributed this variance primarily to unrealized real estate investment purchases and, to a lesser degree, greater than expected private equity investment sales.

In reference to the agenda item concerning the Mutual Fixed Income Fund, Treasurer Nappier commented on the importance of the presentation concerning the use of derivatives for the Mutual Fixed Income Fund, which is being recommended as part of the guidelines for the pending new fixed-income managers. She said that CRA Rogers Casey (“CRARC”) will give this presentation focusing on today’s fixed income marketplace and expand on the report that was included in the agenda package mailed to the IAC.

Chairman Roberts welcomed new member Duke Himmelreich to his first meeting of the Investment Advisory Council.

CRPTF Final Performance for November 2004

Chief Investment Officer Susan Sweeney said that for the month of November 2004, the CRPTF returned a little over 3.0%, which was 22 basis points behind the benchmark. She said that for the calendar year to date, the combined investment fund returned 8.25%, 4 basis points ahead of the benchmark. Ms. Sweeney pointed out that the equity market had a strong year and CRPTF is now at the 60% statutory cap between the Mutual Equity and International Stock Funds.

Watch List Procedures

Ms. Sweeney explained the policies and procedures used by CRPTF for monitoring managers. She pointed out that the Watch List focuses on the publicly traded asset classes in the fund. Ms. Sweeney said that some examples of the kinds of things that would trigger placing a manager on the Watch List would be underperformance for three or more consecutive quarters, turnover, or significant events that occur like the mutual fund scandal in November 2003. She said that scandal triggered the immediate placement of three managers on the Watch List. Ms. Sweeney said that when a concern reaches the point that warrants a recommendation to the Treasurer, one is made. She also noted that a manager can be terminated without being placed on the Watch List first if there are extreme circumstances or the Treasurer can elect to terminate a manager if she feels it is appropriate. Ms. Sweeney said that the IAC is always informed at the next IAC meeting following a termination.

Treasurer Nappier said there have been six or seven terminations during her administration and most of the assets were placed in the Index Fund. She noted that the problem that often arises is knowing where to place the assets of a terminated portfolio to maintain asset allocation and the integrity of the overall portfolio composition rather than having redeployment decisions based solely on the need to place these assets somewhere. Treasurer Nappier said that unless a manager is really egregious, she tries not to terminate them until there is a plan to redeploy the funds.

Ms. Sweeney explained the monitoring process once a manager is placed on the Watch List. She said that in the future, a written report would be provided to the IAC. Mr. Larkin asked how many managers are currently on the Watch List. Ms. Sweeney directed the group to the chart in the package showing 4 managers on the Watch List. She reviewed the circumstance of each manager on the Watch List. Mr. Larkin asked how long a manager would remain on the Watch List. Ms. Sweeney said that there is no stated time.

Ms. Sweeney said that she would be providing a quarterly update on the Watch List. Mr. Larkin remarked that the report was excellent and very clear.

Chairman Roberts asked Ms. LaMarr to talk about the Ethics filing. Ms. LaMarr advised that when an IAC member travels to a conference, especially a conference sponsored by an OTT vendor, it is considered a gift to the State. Inasmuch as a well-informed IAC is of great value to the State of Connecticut, IAC members, as Public Officials, may accept tuition waivers and/or travel expenses as "gifts to the State." Prior to any IAC member, except *ex officio* members, traveling on a "gift to the State" exemption, Chairman Roberts must inform the Ethics

Commission that he approves the proposed travel and that it is valuable to the State. Chairman Roberts may submit such approval for himself. Deputy Treasurer Howard Rifkin noted that the IAC has a budget item set aside for the education of the members of the IAC and that travel requests must be approved by Chairman Roberts. He also cautioned members that when attending a conference whether it is paid for by the IAC budget or by a gift to the State, one should pay for any amenities at the conference and not submit as part of the travel. Ms. LaMarr said that no one should accept as a gift to the State anything other than travel expenses, food and lodging. She noted anything else should be paid for out of pocket.

Chairman Roberts also noted that an annual filing must be submitted to the Ethics Commission in May.

Presentation by and Consideration of Constitution Fund II

Bradley Atkins of Franklin Park stated that Constitution Fund II, L.P. is being formed to continue the strategy of the Constitution Fund. Mr. Atkins gave an overview of the history of the Constitution Fund noting that it is a venture capital fund of funds of which the State of Connecticut is the sole limited partner. He added that the Constitution Fund has generated a 20.7% net internal rate of return since its inception in 1987 making it one of the strongest performers in the Connecticut portfolio. He provided an overview of the strategy of Constitution Fund II noting that it will continue the strategy of investing in top-tier venture capital funds. Mr. Atkins concluded with background information on Fairview Capital Partners (“Fairview”), the current manager of the Constitution Fund, noting it is an established venture capital fund manager.

Presentation by Fairview Capital Partners

Fairview made a presentation to the IAC regarding Constitution II, L.P. Fairview was represented by JoAnn Price, co-founder and president and Laurence Morse, Ph.D., co-founder. Ms. Price spoke briefly about the management transfer of the Constitution Fund (aka: the Constitution Liquidating Fund) from the Crossroads Group to Fairview noting that it was a flawless transition. Ms. Price noted the success of the Constitution Fund. She discussed the opportunity for the State of Connecticut to continue to access top tier venture capital investments through Constitution II.

Mr. Larkin asked Dr. Morse to elaborate on the Freedom of Information Act (“FOIA”) as it applied to private investments. Dr. Morse explained the issues surrounding public disclosure of information on the underlying portfolio companies of venture capital funds, and that many venture capital funds are concerned about certain investors who are subject to FOIA and must reveal such information. Treasurer Nappier noted a recent challenge at Yale University concerning disclosure of its investments and that some pension funds have been challenged to reveal all information at a portfolio level. She said that has not been an issue for Connecticut’s pension fund. Ms. LaMarr said that portfolio level company information is exempt from disclosure under Connecticut’s FOIA statutes. Patricia DeMaras, Associate Counsel, noted that information shared at IAC meetings is public information.

Roll Call of Reactions Constitution Fund II

Mr. Larkin said that he found the presentation to be excellent and is in favor of the commitment. Michael Freeman said that it looks like a solid investment and is happy to move forward. Bill Murray said he has no objection, Peter Thor said yes and Mr. Himmelreich said it looks wonderful. Sharon Palmer said it looks good and feels quite fortunate to be able to continue with them and Ms. Thomas said she agrees and we should build on success. Chairman Roberts said that it is an excellent choice and a commitment should be made.

Chairman Roberts asked for a motion to waive the 45-day comment period. **A motion was made by Ms. Thomas, seconded by Mr. Larkin, to waive the IAC 45-day comment period. The motion was passed unanimously.**

Corporate Governance Backlash Discussion

Meredith Miller, Assistant Treasurer for Policy, noted that the package of articles (Agenda Item #6) included articles that Ms. Thomas asked to have distributed at today's meeting. Ms. Miller explained that the term backlash, when talking about Corporate Governance Backlash, is a term that has been coined in the popular press to describe efforts by the business community to curtail policy makers, regulatory bodies and shareholders who are engaging in efforts to increase board independence and accountability and to put pressure on board members to act in the best interest of shareholders.

Ms. Thomas opened the discussion indicating that she feels that the IAC needs to be aware of and ready to deal with corporate governance backlash in Connecticut, should it ever become an issue for the CRPTF. She said that there seems to be an effort in California to cripple CalPERS by requiring all new employees to use defined contribution plans. Ms. Thomas indicated that it appears that the U.S. Chamber of Commerce and the Business Roundtable are actively trying to prevent anti-corporate shareholder activism and that the American Enterprise Institute has said that public funds should be stripped of their proxy voting rights. Discussion ensued following Ms. Thomas' remarks. Treasurer Nappier noted that her office will always try to engage a company in dialogue before pursuing a shareholder resolution and once a resolution is filed and, if successful in doing so, will withdraw the resolution. She said that there has been much success in that regard and there are a lot of companies embracing corporate governance reform.

Report on Corporate Governance and MacBride Compliance

Ms. Miller reported on the Treasurer's activities related to corporate governance and MacBride compliance for the period ending September 30, 2004. Ms. Miller provided a summary of statistics for both domestic proxy voting and global proxy voting. She said that there were no violations with respect to the MacBride Law and no inconsistencies or violations with respect to the international investment managers voting CRPTF proxies.

Ms. Miller said that some of the more notable successes of the OTT were that the SEC denied Walt Disney Company's request to omit CRPTF's resolution asking for permanent separation of the position of Chairman of the Board and CEO. Ms. Miller noted that subsequent to the SEC denial, the company settled with the OTT and agreed to permanently separate the Chair and CEO positions. Another success reported by Ms. Miller concerned Safeway. In response to the resolution CRPTF co-filed with New York City Comptroller requesting creation of a formal

mechanism for dialogue between independent directors and shareholders, Safeway's lead director has agreed to a meeting to discuss moving forward in a collaborative way; and discussions are separately underway with General Electric, EMC and Wal-Mart on a variety of issues.

Mr. Larkin asked for more information about EMC. Ms. Miller provided a synopsis of the history with EMC related to the diversity resolution originally filed by CRPTF.

Ms. Palmer asked Ms. Miller to provide more information regarding Wal-Mart. Ms. Miller said that CRPTF has co-filed a Global Labor Standards resolution with The General Board of Pension Funds, a member of the Interfaith Center for Corporate Responsibility ("ICCR"). She said that ICCR is holding a conference in about six weeks and that Wal-Mart's CEO has been invited to attend this conference and meet with the proponents of the resolution.

Quarterly Update on CRPTF Cash Flow as of September 30, 2004

This item was tabled until the February 9, 2005 IAC meeting.

Use of Derivatives in Mutual Fixed Income Fund Manager Guidelines

Ms. Sweeney reported that CRPTF is in the contract phase with 13 Mutual Fixed Income Fund ("MFIF") managers. She noted that some contracts are revisions to existing mandates and other are new mandates for Inflation Linked Bonds and Emerging Markets Debt. Ms. Sweeney said that the use of derivatives is widespread in the industry and that several managers would like to deploy a limited amount of derivative usage in the portfolio. She said that Cynthia Steer of CRARC would talk about the topic in detail.

Treasurer Nappier noted that the use of derivatives was on the agenda of a previous IAC meeting in the context of the currency management program and she thought it was important that the issue be discussed with respect to the mutual fixed income class. She said that not only was there a discussion about derivatives when Pension Funds Management was preparing to contract for currency management services, but guidelines were revised. Treasurer Nappier said that the MFIF guidelines are set, but that she wanted to give the IAC the opportunity to express any concerns.

Ms. Steer provided an in depth presentation to the IAC regarding the use of derivatives in the MFIF, noting that derivatives have been in use for almost 25 years. She reviewed Part I, Article VI, Use of Derivatives in the Investment Policy Statement ("IPS"), instruments used to achieve IPS objectives, amounts outstanding of Over-the-Counter derivatives, and the derivative financial instruments traded on organized exchanges by instrument and location. Ms. Steer said that when managers are reviewed for the use of derivatives, CRARC takes into account the manager's size, personnel skills and their risk system. She explained that Part III, Article IV, Mutual Fixed Income Fund Guidelines in the IPS prohibited the use of derivatives without prior consultation with staff and the Treasurer.

Treasurer Nappier noted that the IPS Article VI in Part I should have been included in the agenda package mailed to the IAC along with the proposed new guidelines providing for the use of derivatives. The relevant sections to the IPS were distributed at the meeting and there was brief discussion about the current policy governing derivatives. Treasurer Nappier informed the IAC that, while it was not required, she was seeking IAC review and feedback on this matter prior to

approving the investment guidelines as part of the fixed-income manager contracts, and that the use of derivatives will vary depending on the style of each manager.

Chairman Roberts asked for a one-paragraph write-up about each of these managers indicating what the risk controls are in the firm, their size and any other pertinent information and the mandates that would make sense for each manager. He said he felt this would help clarify the issue for members who may not be familiar with the derivatives market. Ms. Sweeney will provide the IAC members with the requested information.

Mr. Himmelreich expressed that he feels derivatives offer a tremendous opportunity as long as the exposure is reasonable and encouraged Treasurer Nappier and her staff to monitor the total exposure, taking into account exposure in the hedge funds. Treasurer Nappier said that she is aware of the risk of over exposure and that CRARC is evaluating each manager's risk program. Ms. Steer provided the IAC with details of how CRARC evaluates and monitors a manager's risk program.

Other Business

Status Report on Requests by IAC Members

Ms. Sweeney said that **Diversity Principles** are still on deck, as is the **Conference Speakers Who Pay to Speak**.

Ms. Sweeney said that Greg Franklin is trying to obtain the necessary information for the **Cash Flow Projection for Fiscal Year 2006**

Chairman Roberts said that the **Corporate Governance Backlash** and **Watch List Report** will be removed from the list of requests because both were addressed at this meeting.

Discussion of Preliminary Agenda for February 9, 2005 IAC Meeting

Ms. Sweeney said that the Cash Flow Report would be given next month.

There being no further business, the meeting was adjourned at 1:05 P.M.

An audio tape of this meeting was recorded.

Respectfully submitted,

**DENISE L. NAPPIER
SECRETARY**