

**INVESTMENT ADVISORY COUNCIL
WEDNESDAY, February 9, 2005**

MEETING NO. 323

Members present:

Michael Freeman
James Larkin
Reginald Martin
William Murray
Denise L. Nappier, Treasurer
David Roth, Acting Chairman
Carol Thomas
Peter Thor

Absent:

Clarence (Dick) L. Roberts, Jr., Chairman
Representative for Robert L. Genuario
David (Duke) Himmelreich
Sharon Palmer

Others present:

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

Guests:

Donna Trapp, State Street Corporation
Raudline Etienne, CRA RogersCasey
Bradley Atkins, Franklin Park, LLC
Vonda Brunsting, Service Employees International Union
Harvey Kelly, Leumas Advisors
Julie Naunchek, CSEA-Retiree Council #400
Robyn Kaplan-Cho, Connecticut Education Association
Raymond Clarke, Teachers' Retirement Board

Chairman Dick Roberts, knowing he would not be able to attend the meeting, had appointed David Roth as acting chair for the February 9, 2005 meeting. Acting Chairman David Roth called the meeting to order at 10:05 A.M. He noted, for the record, that there was a quorum but several members were absent.

Approval of Minutes

Chairman Roth asked for comments on the Minutes of the January 12, 2005 Investment Advisory Council (“IAC”) Meeting. There being no comments, **a motion was made by James Larkin, seconded by Michael Freeman, that the Minutes of the January 12, 2005 IAC meeting be accepted as drafted. The motion was passed unanimously.**

Opening Comments by the Treasurer

Treasurer Denise Nappier recommended that since the State of Connecticut Retirement Plans and Trust Funds (“CRPTF”) is in the process of beginning the asset allocation liability study, the study begin with a project orientation presentation to be held in a special meeting. She said that this meeting could be an orientation session for both the study as well as the ongoing examination of hedge funds as a potential asset class or investment strategy. Treasurer Nappier said that Judy Balich would be contacting members to determine their availability to meet before the March IAC meeting.

Treasurer Nappier said that based on the presentation by Fairview Capital on Constitution Fund II, the favorable feedback from the IAC and the IAC’s waiver of the 45-day comment period, she has made a decision to make a \$200 million commitment to Fairview’s Capital Constitution Fund II.

Treasurer Nappier said that the IAC would be hearing from two principals from GarMark Partners II, L.P. (GarMark II), an existing Private Investment Fund manager. She noted that the CRPTF committed \$75 million to GarMark Partners I, L.P. (“GarMark I”) in 1998, that it is a top tier performer, and that she is recommending the General Partner as CRPTF’s preferred manager for GarMark II.

Treasurer Nappier reminded the IAC that at last month’s meeting there was a presentation on the use of derivatives. She said that on the agenda today is a full presentation on the recommended guidelines for derivative use by certain Mutual Fixed Income Fund managers and that she welcomes feedback from the IAC prior to finalizing the guidelines.

Treasurer Nappier reported that with regard to corporate governance, the SEC ruled in favor of Halliburton to exclude the shareholder resolution on access to the proxy for the purposes of nominating board candidates. She also reported that Donald Kirshbaum, Investment Officer of the Policy Unit, testified before the State Legislative Committee on Environment. She said that the hearing was on climate risk and that the Office of the Treasurer (“OTT”) offered to be of any assistance to the Legislature as they go through their review. Treasurer Nappier noted that the OTT continues to engage directors and senior management of CRPTF’s portfolio companies in meaningful conversations on a number of corporate governance matters and that there are meetings

scheduled with the lead independent director of the compensation committee of General Electric and the CEO of Wal-Mart. She also noted that a meeting was recently held with the lead independent director and the CEO of Safeway to discuss governance issues.

Following Mr. Larkin's question about a possible adjustment on the investment return, there was a discussion about the investment return assumption, actuarial assumptions and funding of the Connecticut State Teachers' Retirement System and the Connecticut State Employees' Retirement System. Mr. Larkin suggested that the IAC and the Treasurer should jointly take a stand on what an appropriate investment return assumption should be, based on current capital markets. Mr. Roth agreed that the Treasurer and the IAC should officially encourage the Legislature to be more realistic in their assumptions.

Treasurer Nappier asked Larry Wilson, Assistant Treasurer of Cash Management, to introduce the new staff member of the OTT. Mr. Wilson introduced Lee Ann Palladino, Principal Investment Officer, who will be replacing Hal Johnson, retired Principal Investment Officer. Ms. Palladino said that she is happy to be with the Treasury.

CRPTF Final Performance for December 2004

Chief Investment Officer Susan Sweeney said that for the month of December 2004, the CRPTF returned 2.58%, which was 33 basis points under the benchmark. She reported that for the month the Mutual Equity Fund ("MEF") underperformed its benchmark by 9 basis points, International Stock Fund ("ISF") outperformed its benchmark by 32 basis points and the Mutual Fixed Income Fund ("MFIF") came in slightly under its benchmark. Ms. Sweeney reported that the Real Estate Fund ("REF") underperformed, but that it is currently under allocated and that CRPTF is in the process of getting back into the market with commitments. Ms. Sweeney reported that for the full year the MEF underperformed by 34 basis points, almost entirely attributable to Brown Capital Management's large underperformance of 82 basis points. She said that next month she would report on the TUCs ranking. Ms. Sweeney noted that as of the end of the year, CRPTF has 61% invested between the MEF and ISF which is slightly above the statutory cap, but that percentage probably came down during the month of January. She noted that Pension Funds Management ("PFM") is keeping track of the statutory cap of 60%.

Chairman Roth noted that the median endowment performance was about 15%, but that CRPTF is in a public funds universe, which did not do as well. He asked how much of an ISF manager's performance is absolute and how much is because of currency valuation. Ms. Sweeney responded that ISF managers report the total return of their accounts, and CRPTF has a separate currency overlay program with Bank of New York and Bridgewater. She said that PFM is working with CRA RogersCasey ("CRARC") to get a clear performance attribution report for the currency overlay managers. Raudline Etienne of CRARC said that there is a broad macro of attributions for the ISF in the quarterly report.

Presentation by and Consideration of GarMark Partners II, L.P.

Bradley Atkins of Franklin Park reported on the due diligence it conducted on GarMark II. Mr. Atkins stated that GarMark II is a middle market mezzanine fund based in Connecticut. He also

noted that GarMark I has returned 1.8 x times invested capital for a 13% net internal rate of return, resulting in first quartile performance relative to other mezzanine funds as well as other buyout funds. Mr. Atkins noted that he was concerned with the personnel turnover, but added that GarMark has satisfactorily addressed these issues and that Franklin Park is recommending a commitment in the amount of \$75 million to GarMark II.

A discussion ensued relative to the turnover in staff and the implication to the Fund if the key partner were to depart. David Scopelliti pointed out that there is a “key man clause” in the contract.

William Murray asked for additional information on mezzanine investments. Chairman Roth added to the question inquiring about the risk and return. Mr. Atkins explained the investment type as well as the risk and return structure.

Presentation by GarMark Partners

GarMark Partners made a presentation to the IAC regarding GarMark Partners II, L.P. GarMark was represented by Garrett Bewkes, managing partner and Steven Pickhardt, partner. Mr. Bewkes gave the history and an introduction of GarMark I. He also provided information regarding performance data, investment strategy, the management team and an overview of the firm’s corporate citizenship activities. Mr. Pickhardt discussed the market opportunity, proprietary deal flow, credit and underwriting standards and provided a summary of terms.

Chairman Roth asked about (i) the type of securities in which they invest and the criteria used to determine whether or not the investment will be made, (ii) if they had to restructure securities and/or take an active role in the day to day management of any companies and (iii) how many investments the firm intended to target in the new fund. Reginald Martin asked if there were any females or minorities being considered for staff at GarMark. Mr. Larkin asked about (i) the distribution of returns, (ii) the names of some of the companies in which they are invested, (iii) the names of some of the investors and (iv) what would happen should Mr. Bewkes or Mr. Pickhardt leave the company. Carol Thomas asked about the General Partner commitment of \$5 million and if that is an ordinary percent. Peter Thor asked for an explanation of the firm’s statement that it had an “independent focus”. All questions were satisfactorily answered.

Roll Call of Reactions for GarMark Partners II, L.P.

Mr. Larkin said that it is a good investment. Mr. Freeman said that he would go ahead without reservation. Mr. Murray said that he liked the diversity of their investments and is in favor of making the investment. Mr. Thor said that he supports the investment. Mr. Martin said that his reservations were put to rest by the answers given by GarMark and he is for the investment. Ms. Thomas said that she is comfortable with the investment. Chairman Roth said that he is in favor of the investment and feels that the mezzanine asset class is a good opportunity.

Mr. Martin requested that managers provide a glossary with their presentations. Treasurer Nappier said the OTT should include the glossary in the report to the IAC prior to its meeting. Mr. Martin inquired about the “Side Letters”. General Counsel Catherine LaMarr explained the

topics addressed in "Side Letters". Mr. Martin asked if the OTT would monitor GarMark's progress in diversifying their workforce. Treasurer Nappier said that all managers are required to provide reports.

Chairman Roth 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.**

Quarterly Update on CRPTF Cash Flow as of September 30, 2004 and December 31, 2004

Greg Franklin, Assistant Treasurer of Investments, reported that the CRPTF is well positioned to make all benefit payment requirements going forward. He said there are options available to generate additional cash if the need should arise. Mr. Larkin asked where the projections are for 2006. Mr. Franklin explained that PFM is relying on the asset liability study and is in the process of obtaining the liability data from each retirement board and forwarding it to the consultant who will be providing PFM the information that will actually project out beyond 2006.

Mr. Franklin gave an update on CRPTF Cash Flow through December 31, 2004, noting that for the period ending December 31, 2004 there was a net outflow of \$513 million. He noted that even with cash that was available, it was necessary to come up with an additional \$148 million to cover the net outflows. He said there were \$85 million in investment purchases and \$184 million in investment sales for a net inflow of approximately \$100 million from purchases and sales. Mr. Franklin said that sweeps came in at \$453 million and that all of this left CRPTF with a cash balance of \$404 million at the end of December.

Treasurer Nappier said that the bottom line is that CRPTF has more cash based on actuals for the first six months of the fiscal year than was initially estimated. She said that the difference between projected versus actual is driven by the fact that there were unrealized investment purchases, primarily in the real estate area. She advised that the schedule for investment purchases has been readjusted. Treasurer Nappier also noted that the amount of sweeps has been reduced. A discussion ensued relative to these points made by Treasurer Nappier.

Other Business

Description of Fixed Income Guidelines Including use of Derivatives

Ms. Sweeney distributed the information to the IAC and Chairman Roth said that since there were four IAC members absent, he felt that the discussion should be deferred until there was a larger complement. Deputy Treasurer Howard Rifkin said that the Treasurer would have to excuse herself from the meeting now because she is due at the General Assembly for the Governor's budget presentation and that it is a good idea to defer the discussion. Treasurer Nappier said that the issue is that there are 16 managers in the contract negotiation phase and one reason the discussion regarding derivatives is on the agenda is because she felt a desire to get the IAC's feedback prior to finalizing the managers' investment guidelines that are part of the contract. She noted that the Treasury Reform Act does not require the IAC to review investment manager guidelines, but because the guidelines are going to include the managers' use of

derivatives, she thought it was important for the IAC to review them. She also noted that it was her expectation that this would have been done in January. Treasurer Nappier suggested that the discussion can take place in March, but she would appreciate it if everyone would take the time to review the guidelines and call her with any questions or concerns. She said that if the IAC expresses a lot of questions or concerns then she would table making any decisions on the guidelines in the contract with these managers.

Mr. Larkin expressed that he felt that there should be a section included in the handout that clearly define derivatives. Ms. Sweeney responded that the package being handed out includes defined levels of expertise by manager, a glossary of all the permitted derivatives that will be allowed in the guidelines, and a paragraph on each manager being contracted with in emerging markets debt and inflation linked bonds with specifics on which of those glossary terms they are going to be allowed and to what extent. Deputy Treasurer Rifkin asked the IAC members in attendance to offer comments by the middle of next week and that the members who are not present will be sent copies with a note asking for the same thing. Chairman Roth asked the IAC members to make comments or concerns to the Treasurer by either phone call or e-mail.

Status Report on Requests by IAC Members

Ms. Sweeney said that due to time constraints on some other pressing issues there has not been a lot of progress made on **Diversity Principles** and **Conference Speakers Who Pay to Speak**.

Ms. Sweeney said that Mr. Franklin answered the question about providing **Cash Flow Projection for Fiscal Year 2006** and it will be removed from the Status Report.

Ms. Sweeney said that the request for a one-paragraph write-up for each MFIF manager regarding **Derivatives** would be removed from the list of requests because the information was distributed at this meeting. However, there will be a discussion regarding Derivatives at the March IAC meeting.

Mr. Larkin asked about the status of the commitment to Rockwood. Ms. Sweeney said that the fund is closed and that they have drawn down at least 50% of the \$40 million commitment and that the OTT has a seat on their advisory board.

Discussion of Preliminary Agenda for March 9, 2005 IAC Meeting

Ms. Sweeney said that next month is a quarterly meeting and that there will be a discussion on Derivatives, the TUCs report, and possibly a presentation for a real estate investment opportunity.

Chairman Roth said that he would find it helpful to have an informational report on performance manager by manager at the end of a calendar year. He said he would like a report on the managers of publicly traded securities rather than just the private equity asset class, and that he would like information such as performance for the year against the managers' benchmarks, their ranking within their universe, what quadrant they are in, what their standard deviation was and how much risk they took. Mr. Larkin said that he supported the request 100%. Deputy Treasurer Rifkin said that the Treasury has that information and more in a detailed quarterly

report prepared by CRARC, but that the challenge will be to provide it to the IAC in a format that would be useful to them. There was a discussion about the available information and the format. The final outcome was that Chairman Roth said that since the next meeting is a quarterly meeting, the IAC could look at the quarterly book and see if it does provide the information the IAC needs or whether additional information is needed.

Deputy Treasurer Rifkin said that in years past, the IAC has had a periodic conversation about the statute that details that the IAC will annually review the investments of the Fund and what that means. He said that the same discussion might be worth having with the newly constituted IAC.

There being no further business, the meeting was adjourned at 12:15 P.M.

An audio tape of this meeting was recorded.

Respectfully submitted,

**DENISE L. NAPPIER
SECRETARY**