

INVESTMENT ADVISORY COUNCIL
WEDNESDAY, January 11, 2006

MEETING NO. 332

Members present:

Thomas Fiore, representing
Robert L. Genuario
James Larkin
Reginald Martin
William Murray
Denise L. Nappier, Treasurer
Sharon Palmer
Clarence (Dick) L. Roberts, Jr., Chairman
David Roth
Carol Thomas
Peter Thor

Absent:

Michael Freeman
David (Duke) Himmelreich

Others present:

Howard G. Rifkin, Deputy Treasurer
Susan B. Sweeney, Chief Investment Officer
Pamela Bartol, Assistant 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
Donald Kirshbaum, Investment Officer
Catherine E. LaMarr, General Counsel
Shelagh McClure, Director of Compliance
Meredith Miller, Assistant Treasurer-Policy
Linda Tudan, Executive Assistant to the Treasurer
Judy Balich, Executive Secretary
Sarah Carter, Administrative Assistant

Guests:

Vonda Brunsting, Service Employees International Union
Raudline Etienne, CRA RogersCasey
Robyn Kaplan-Cho, Connecticut Education Association
Harvey Kelly, Leumas Advisors
Maria Luce, State Street Corporation
Julie Naunchek, CSEA-Retiree Council #400
Daniel Schmitz, CRA RogersCasey

Chairman Dick Roberts called the meeting to order at 9:05 A.M.

Approval of Minutes

Chairman Roberts asked for comments on the Minutes of the December 14, 2005 Investment Advisory Council ("IAC") Meeting. Chairman Roberts said that Treasurer Denise Nappier has comments on the minutes and that consequently, the minutes will not be approved today and will be redrafted for distribution and approval at the February IAC Meeting. Treasurer Nappier explained how the December 2005 IAC minutes needed to be clarified to accurately and fully reflect her report on the redeployment of liquidated assets from the Morgan Stanley and TIMCO portfolios.

Opening Comments by the Treasurer

Treasurer Nappier provided the IAC with an update on presentations made at the December IAC Meeting by Syndicated Communications Venture Partners V, L.P ("Syncom V") and Cornerstone Real Estate Advisors ("Cornerstone"). She reported that after reviewing the due diligence reports provided by the consultants, considering the IAC comments and receiving the waivers of the 45-day comment period, she decided to commit up to 10% of Syncom V's \$350 million objective and \$75 million to Cornerstone for the Cornerstone Property Fund. Treasurer Nappier noted that both commitments are pending satisfactory completion of contract negotiations.

Treasurer Nappier reported on a press conference held last week at which the Speaker of the House, along with the Majority Leader and other legislators, announced plans to recommend using a portion of the surplus dollars for the Teachers' Retirement Fund (TERF). She said the proposed appropriation would place the state's pension contribution at 100% of the actuarial recommendation for the current biennium. According to Treasurer Nappier, conceptually there is bi-partisan support, which includes the Governor's Office and the Minority Leader, for using surplus dollars to help address TERF's unfunded liability now at \$5.2B, but that what may be in contention is the actual dollar amount to be funded with surplus dollars. Aside from this proposal, Treasurer Nappier reported that TERF has received \$50M of the \$100M committed from surplus based on previous legislative action, and that the remaining amount will be made in fiscal year 2007.

Treasurer Nappier called the IAC's attention to two agenda items. She said that one item is the project plan for conducting a Mutual Equity Fund structure review, noting that the IAC would be involved in the study and that she anticipates that the study results may lead to modifications to the Investment Policy Statement ("IPS") and a search for new managers. Treasurer Nappier said the other item is a plan to issue a Request for Proposal ("RFP") for proxy voting services. She explained the timeliness of this search as driven by the growth in the scope and breadth of services now covered in this industry and the high level of the CRPTF shareholder activity. Treasurer Nappier said that Assistant Treasurer Meredith Miller would discuss the recommended procedures in more detail and would also provide an overview of the quarterly Corporate Governance report.

Treasurer Nappier highlighted several matters pertaining to corporate governance. She said that as a result of a resolution filed by the CRPTF with the Ford Motor Company ("Ford") during the 2005 proxy-voting season, Ford recently released a report examining the business implications of reducing green-house gas emissions. In preparation for the 2006 proxy-voting season, she noted that the CRPTF has filed eleven shareholder resolutions. She also informed the IAC that a primary corporate governance issue has been, and will continue to be, executive compensation and full disclosure of the entire pay package. Treasurer Nappier said that the Securities and Exchange Commission ("SEC") is reviewing executive compensation and would be meeting on January 17, 2006 to discuss the issue of proper disclosure of executive compensation. She said that the Office of the Treasurer ("OTT") sent a letter to the SEC communicating its position on executive compensation.

Peter Thor reported that he recently attended a conference sponsored by AFSCME for pension fund participants, where the State of Connecticut and Treasurer Nappier were singled out for their distinguished efforts in corporate governance.

CRPTF Final Performance for November 2005

Chief Investment Officer Susan Sweeney said that for the month of November 2005, the CRPTF returned 3.28%, which was 29 basis points ahead of the benchmark. She said that for the fiscal year to date and the calendar year the CRPTF outperformed its benchmarks by 35 basis points and 150 basis points, respectively. Ms. Sweeney said that the market value of the total fund is over \$22 billion, close to its high of \$22.3 billion.

Ms. Sweeney reported that for the month, the MEF outperformed the Russell 3000 by 20 basis points and the S&P 500 by 31 basis points. She said that this return was largely due to Barclay Global Investors' strong performance, which exceeded the S&P 500 by 60 basis points, noting that this fund accounts for \$3.85 billion of the CRPTF portfolio. Ms. Sweeney reported that the small/mid cap segment of the portfolio returned 4.1%, 73 basis points below the Russell 2500, noting that there was a negative impact because of the termination of TIMCO and the time required to terminate, evaluate and move the funds. She indicated that Brown continued to do well, outperforming their benchmark by 28 basis points for November and noted that since the CRPTF reduced the funds invested with Brown to \$177 million, Brown has increased the fund to \$197 million.

Ms. Sweeney said that the Connecticut Horizon Fund ("CHF") managers are up and running with Bivium Capital returning 5.45%, outperforming the Russell 2000 by 59 basis points; Capital Prospects matching the Russell 3000 return; and FIS Funds Management slightly outperforming the Russell 3000.

Ms. Sweeney said that the ISF returned 4.6%, 4 basis points ahead of its benchmark, while the Mutual Fixed Income Fund ("MFIF") returned 0.46%, 7 basis points below its custom benchmark and 2 basis points ahead of the Lehman Aggregate. She said that both the Private Investment Fund and the Real Estate Fund had strong returns, a result of a number of resets and valuations triggered by the end of a quarter. Ms. Sweeney said that the Cash Reserve Account ("CRA") performed 3 basis points ahead of its benchmark for the month.

Mr. Larkin questioned whether CRPTF staff was satisfied with the performance of the ISF. Ms. Sweeney responded that two core managers have been terminated and that CRPTF is in the process of trying to repopulate that segment and hire two managers that can contribute to performance. She said that there are a couple of managers in the small cap area that are being monitored, one of which is Morgan Stanley and that she has a conference call scheduled with Morgan Stanley later this week. Ms. Sweeney noted that emerging markets has been very strong and the currency managers have done a great job. Treasurer Nappier remarked that even though the ISF is underperforming its benchmark, recent performance of the international markets has been much higher than the domestic market.

Treasurer Nappier asked Ms. Sweeney to brief the IAC on the status of the MFIF contracts, noting some delays in fully implementing the structure put in place a couple of years ago. Ms. Sweeney indicated that contract negotiations are almost complete. She said that all but one of the Core contracts have been executed and that the remaining contract is with the Office of the Attorney General ("OAG"). She said that there are a couple of outstanding High Yield manager contracts but, as those are existing managers, neither requires new funding and therefore will not result in a change to the portfolio for the High Yield managers. Ms. Sweeney said of the four Emerging Markets Debt ("EMD") managers originally selected, Ashmore Investment Management has been funded for most of the year; contract negotiations were recently concluded with Bridgewater Associates and that contract is in the process of being finalized; and the two remaining EMD managers that were selected as preferred vendors are Pacific Investment Management Company ("PIMCO") and Citigroup Asset Management ("Citigroup"). She said that PIMCO's lead portfolio manager for EMD has announced that he is leaving PIMCO to become the new head of Harvard University's endowment fund. She said that CRA RogersCasey ("CRARC") would provide an updated evaluation of the EMD management team at PIMCO, but CRARC continues to be supportive of the investment with PIMCO. Ms. Sweeney said that there are also remaining contract issues with PIMCO and that the most difficult issue involves language in the contract that flows from CRPTF's statutory obligation on terrorism reporting. She said that Assistant Treasurer Greg Franklin and Associate Counsel Patricia DeMaras have been negotiating that language, but it remains problematic. Regarding the Citigroup contract, Ms. Sweeney said that Citigroup would not be part of the Legg Mason acquisition and they would be a separate entity. She said that the situation is evolving and CRPTF is working with CRARC to evaluate the impact on the team and their ability to manage the fund. Ms. Sweeney said that there are other options to present if the issues with these two managers cannot be resolved. She said that one option that may be presented to the Treasurer would be to conduct an expedited search, similar to the search for the ISF, and obtain a short list of buy rated emerging markets debt managers from CRARC with which to conduct the search.

Treasurer Nappier expressed her concern regarding the delay in executing these contracts and indicated her desire for the negotiations to be concluded one way or the other. She said that CRPTF could not continue with the impasse because she believes that, particularly in the EMD area, CRPTF could be harmed by not having funded managers.

Mr. Larkin asked how CRPTF would look for a benchmark for real estate. A discussion followed regarding the lack of available real estate benchmarks, which is due to the complexity of the market.

Reginald Martin asked for an explanation of “emerging” as it pertains to the international market. Ms. Sweeney explained that emerging markets are the undeveloped markets in countries such as Malaysia, India and African countries. Mr. Martin said that he would like to see a list of the countries. Raudline Etienne of CRARC said that the countries are listed in the large quarterly report and that she would provide Mr. Martin with either the report or a list of the countries. William Murray said that he would like to see what CRPTF’s investments are in the emerging markets. Ms. Sweeney said that PFM could provide a presentation on CRPTF’s investments in the emerging markets. Discussion ensued regarding investing in undeveloped markets including Mr. Martin’s interest in South Africa investments. Treasurer Nappier reported that she was in the process of completing her due diligence on a promising fund offering with a South Africa investment strategy and expected to present it before the IAC at its next meeting.

Securities Lending Review

Jeffrey Trencher of State Street Bank provided a review of the Securities Lending activity for the quarter ending November 30, 2005. His report included a balance and utilization summary, an earnings summary, the portfolio characteristics and a portfolio strategy summary.

At the request of IAC members, Mr. Trencher said that in the next Securities Lending Review report he would include data comparing the State of Connecticut with other plans, State Street’s fees, the improved performance figure compared to fiscal year 2005 and a glossary.

Quarterly Update on CRPTF Watch List

Ms. Sweeney provided an update on the CRPTF Watch List, noting that the report is very brief. She said that since the last Watch List report, two of the three managers on the Watch List have been terminated. Ms. Sweeney reported that the remaining manager Brown Capital, a domestic equity manager with approximately \$197 million of CRPTF’s assets, has been outperforming its benchmark since being placed on the Watch List. She said that over the longer term, Brown has lagged its custom benchmark by 628 basis points, 757 basis points and 669 basis points for the two, three and five year periods, respectively. However, Ms. Sweeney pointed out that since inception, Brown Capital has outperformed its benchmark by 207 basis points and CRPTF continues to monitor this manager.

Consideration of Recommended Project Plan for Mutual Equity Fund Structure Review

Ms. Sweeney informed the IAC that the materials they received were prepared by CRARC on the process CRPTF plans to undertake to review the structure of the MEF. She said that the fund structure was prompted by manager terminations and the fact that CRPTF has over \$8.5 billion managed by five managers. Ms. Sweeney reviewed the current fund structure and the process. She said that Treasurer Nappier is asking the IAC to endorse the Structure Review Process. Treasurer Nappier noted that step 12 of the process would be changed to reflect the IAC’s role to endorse. David Roth noted that it would have been helpful to have the strategy of each manager’s fund on the MEF structure chart provided by CRARC. Ms. Sweeney provided the strategy for each manager. Chairman Roberts asked for any comments, suggestions or questions on the process. Mr. Roth asked about the integration between this structure review and the asset

allocation study currently underway. Ms. Sweeney said that it would be a concurrent process to the asset allocation study.

Chairman Roberts asked for a motion to accept the recommended project plan for the Mutual Equity Fund structure review. **A motion was made by Carol Thomas, seconded by Mr. Larkin, to accept the recommended project plan for the Mutual Equity Fund structure review. The motion was passed unanimously.**

Consideration of Recommended Procedures for Proxy Voting Consultant Search

Ms. Miller provided an overview of the recommended procedures for the Proxy Voting Consultant search referring to the Action Plan and the Screening and Selection Criteria, which were distributed with the IAC package. She said that the types of services have changed and that the number of vendors offering these services has increased and the timing is right to update the services provided to the CRPTF. There was a discussion relative to the search process. Chairman Roberts said that the IAC would need to endorse the procedure. Treasurer Nappier pointed out that the screening criteria and selection criteria require endorsement by the IAC in accordance with the Investment Policy Statement ("IPS").

Chairman Roberts asked for a motion to endorse the recommended procedures for the proxy voting consultant search. **A motion was made by Peter Thor, seconded by Mr. Larkin, to endorse the recommended procedures for the proxy voting consultant search. The motion was passed unanimously.**

Report on Corporate Governance and MacBride Compliance

Ms. Miller reported on the Treasury's activities related to corporate governance and MacBride compliance for the period ending September 30, 2005. She provided a list of CRPTF shareholder proposals for 2006 session. Ms. Miller said that the global proxy voting is in compliance for the third quarter and can be viewed on the OTT web site. She said that, as reported in Treasurer Nappier's opening comments, the focus of the 2006 proxy voting season is on executive compensation and that the CRPTF has filed a resolution with Pfizer on executive compensation and disclosure issues. A discussion ensued regarding executive compensation and disclosure.

Chairman Roberts asked what the term "sustainability" as used in the 2006 CRPTF Shareholder Proposal document means. Ms. Miller explained and a discussion followed.

Ms. Miller reported that there have been no violations of the MacBride Principles.

Quarterly Update on CRPTF Cash Flow as of October 31, 2005

Mr. Franklin provided an update on CRPTF cash flow through October 31, 2005. He reported that a one-time surplus appropriation of \$50 million to the Teachers plan is included in the January 2006 estimate, which is the reason for the positive number for net flows. Mr. Franklin

said that the CRPTF is expecting another one-time surplus appropriation of \$50 million in fiscal year 2007 to the Teachers plan.

Mr. Franklin advised the IAC that Treasurer Nappier has initiated a cash review project that encompasses all the divisions within the OTT. He said that within the Pension Funds Management Division there are four components that are considered cash. He explained that besides the CRA, each of the other funds maintain manager cash, investment inventory cash and a distribution cash account. Mr. Franklin said that all of the cash accounts are being considered in conjunction with the asset liability study and that at some point, a determination would be made with regard to sufficient cash levels as well as means by which cash returns could be enhanced. He noted that this might lead to an update of the CRA guidelines in the IPS.

Treasurer Nappier commented that the cash level is less than earlier projections and should remain so going forward, indicating a more efficient projection of CRPTF's cash requirement. Discussion ensued regarding cash estimates, requirements and the possibility of further contributions of \$246 million dollars to the Teachers' fund from anticipated surplus dollars.

Mr. Fiore noted that CRPTF is draining its assets by using interest income and dividends, which should really be reinvested in the plan. Treasurer Nappier said that is one of the reasons that there are discussions taking place relative to introducing an "ear marked" cash program that would be separate and apart so that CRPTF's asset allocation is not altered because of its cash requirements. Treasurer Nappier noted that in the last seven years, contributions have grown by 2.6%, while benefit payments have grown by 9.6%.

Other Business

Status Report on Requests by IAC Members

Ms. Sweeney reported that the draft **Diversity Principles** is very close to completion. OTT staff are working on an updated draft to present to Treasurer Nappier.

Discussion of preliminary agenda for February 8, 2006 IAC meeting

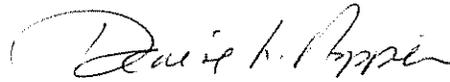
Ms. Sweeney said that at the February meeting, a draft of the Diversity Principles may be presented, a presentation from a private equity fund focused on South Africa may be presented, General Counsel Catherine LaMarr would talk about campaign contribution rules and there would be an analysis of emerging markets exposure. Mr. Larkin asked if the OTT would consider inviting someone from the Wharton School or Harvard University with expertise in international economies to make a presentation to the IAC. Ms. Sweeney said that she and Ms. Etienne had discussed the possibility of asking Antoine van Agtmael from Emerging Markets Investor Corporation to an IAC meeting and that inviting an academic is a good idea. Treasurer Nappier said that ongoing continuing education for the IAC is important. She said that during the last asset allocation liability study in 1999-2000, much time was devoted to obtaining information on the emerging markets, including presentations from experts in the industry, prior to deciding to invest in emerging markets. Treasurer Nappier noted that it was five years ago and a lot has changed in emerging markets since that time. A discussion regarding emerging markets ensued.

Ms. Palmer said that she noticed new Government Accounting Statistic Board ("GASB") rules for corporations in the newsletter distributed earlier at the meeting. She said that there are also new rules for municipalities and other public state entities as well and asked about the possible impact on CRPTF. Mr. Fiore said that there is a GASB rule regarding accounting for health benefits and other appropriate time and that the Comptroller's office is working on those figures. Deputy Treasurer Rifkin said that at some point, Dr. Thomas Woodruff, the Director of Benefits and Retirement Services at the Comptroller's Office, could come in and talk about the scope of the analysis and what the Comptroller's Office has done thus far.

There being no further business, the meeting was adjourned at 11:00 A.M.

An audio tape of this meeting was recorded.

Respectfully submitted,



DENISE L. NAPPIER
SECRETARY