

INVESTMENT ADVISORY COUNCIL
Wednesday, May 8, 2013

MEETING NO. 405

Members present:

Neil G. Budnick, Chairman
Janice (Jan) Carpenter
Thomas Fiore, representing Benjamin Barnes
Michael Freeman
Laurence N. Hale
Joshua Hall
David (Duke) Himmelreich
William Murray
Carol Thomas
Peter Thor*

Absent:

Denise L. Nappier, Treasurer

Others present:

Christine Shaw, Deputy Treasurer
Lee Ann Palladino, Chief Investment Officer
Gary Carter, Interim Deputy Chief Investment Officer
Francis Byrd, Assistant Treasurer - Policy/Corporate Governance
Catherine E. LaMarr, General Counsel
Shelagh McClure, Director of Compliance
Terrence Purcell, Principal Investment Officer
Reginald Tucker, Investment Officer
David Barrett, Director of Communications
Linda Tudan, Executive Assistant
Winifred (Winnie) Scalora, Executive Secretary

Guests:

Bradley Atkins, Franklin Park Associates
Mary Dunleavy, State Street Bank & Trust
Sean Gill, NEPC
Robin Kaplan-Cho, Connecticut Education Association
Louis Laccavole, SOC Teachers' Retirement Board
Liz Smith, AllianceBernstein Institutional Investments
Claire Shaughnessy, Hewitt EnnisKnupp, Inc.

* Arrived at 9:48 a.m.

With a quorum present, Chairman Neil G. Budnick called the Investment Advisory Council ("IAC") meeting to order at 9:00 a.m.

Approval of Minutes of the April 10, 2013 IAC Meeting

Chairman Budnick called for a motion to approve the minutes of the April 10, 2013 IAC meeting. **There being no comments, a motion was made by Michael Freeman, seconded by Janice Carpenter, that the minutes of the April 10, 2013 IAC meeting be accepted as drafted. The motion was passed unanimously.**

Comments by the Deputy Treasurer

Deputy Treasurer Christine Shaw announced that after considering the feedback from the IAC and the due diligence process, Treasurer Nappier decided to commit up to \$100 million to Landmark Equity Partners XV, L.P. She also announced Treasurer Nappier's decision to hire BNY Mellon Asset Servicing for the master custodian mandate. Deputy Treasurer Shaw noted that both contracts were subject to successful contract negotiations. In response to Laurence Hale's question, she said that Deutsche Bank has been selected for the securities lending mandate, and that Treasurer Nappier has announced this decision at a prior meeting of the IAC.

Update on the Market, the Connecticut Retirement Plans and Trust Funds Final Performance for the Quarter Ended March 31, 2013

Lee Ann Palladino, Chief Investment Officer ("CIO"), provided an update on the capital market environment, its impact on the performance of the Connecticut Retirement Plans and Trust Funds ("CRPTF") and the economic outlook. Ms. Palladino said that the macro-economic events that had driven the markets in Fiscal Year ("FY") 2013 encouraged risk taking, and she noted that all of the CRPTF's asset classes posted positive results fiscal year-to-date, led by equities and higher risk fixed income investments. She discussed the macro-economic market themes that were influencing the market results in FY 2013, noting that the equity markets were responding to predictable but measured economic growth, the lack of major downside risks, and the presence of abundant liquidity associated with the unprecedented monetary policy throughout the world. As a word of caution, Ms. Palladino said a key catalyst to halting these impressive upward movements could be the elimination of monetary policy and that during FY 2014 and FY 2015, these events would be monitored closely. In response to Chairman Budnick, Ms. Palladino said that the Office of the Treasurer ("OTT") performed sensitivity analysis of the movements in interest rates and other economic factors on an *ad hoc basis*.

Next, Ms. Palladino provided a performance review for the CRPTF for the quarter ended March 31, 2013. She stated that the CRPTF now included fifteen plans and trusts with the addition of the Other Post-Employment ("OPEB") Trust Fund. Ms. Palladino noted that net investment returns were positive over all time horizons and there had been an exceptional increase in returns since the quarter ended December 31, 2012. She reported that the CRPTF had increased 12.07% fiscal year-to-date with 4.37% of that return through March 2013. As she continued her quarterly report, Ms. Palladino stated that the three-year return was 8.23%, the five-year return was 4.48% and the ten-year return was 7.81%, and added that the CRPTF returns showed a

marked improvement over the last five to seven years. Finally, Ms. Palladino reported that the CRPTF's ending market value as of March 31, 2013 was \$26.3 billion up \$2.9 billion fiscal year-to-date.

Ms. Palladino then discussed the cash flow for the Teachers' Retirement Fund ("TERF"), State Employees' Retirement Fund ("SERF") and Municipal Employees' Retirement Fund ("MERF"). Ms. Palladino stated that contributions were not expected to equal disbursements. In discussing the cash flow trends, Ms. Palladino said that it was critical to measure how the plans were performing versus the projections. She indicated that since 1999, pension benefits had been greater than contributions, which indicated a structural cash deficit, and noted that other plans throughout the U.S. with similar demographics had experienced net cash outflows. She reiterated that the purpose of the pension plan was to provide a reliable source of income in order to help the State meet its obligations to pay pension benefits to retirees. Ms. Palladino noted that the Liquidity Fund ("LF") was created in 2005 to strategically manage the cash and net benefit outflows with the expectation of earning incremental returns over money market rates. She reported that the LF earned 108 bps over the five-year time period and outperformed its benchmark by 50 bps. She added that the LF ensured that the CRPTF had adequate access to cash during the economic crises. Finally, she reported that despite over \$7 billion of cash outflows to meet benefit payments over the past ten-year period, the CRPTF had grown from \$17.2 billion to \$26.3 billion- having earned \$16.1 billion. In response to William Murray, she said that the State's annual contribution was determined by an actuary and that the employees' contribution rate is fixed as a percent of salary.

Next, Ms. Palladino commented on the TERF's strong performance, and reported that FY to date, equities returned 18.5%; fixed income returned 5.1%; and alternatives returned 5.5%, bringing FY to date results to 12.22%. Ms. Palladino reported on the performance of several trust funds.

In closing, Ms. Palladino stated that the Asset Allocation and Liability Study working group recently met and finalized the asset allocations for the remaining three trust funds. She said that the Investment Policy Statement revisions that reflected this work would be presented at the upcoming June IAC meeting.

Report on the CRPTF Compliance Policy for Implementation of Statutory Investment Restrictions

Shelagh McClure, Director of Compliance, provided an annual report regarding activities of the OTT under Connecticut's Sudan and Iran laws. Ms. McClure began by stating that during the past calendar year-to-date, the CRPTF had engaged about fifteen companies in the Iran energy sector, and as a result on April 2, 2013, the Treasurer decided that the CRPTF would divest from and restrict future direct investment in six companies: China National Offshore Oil Corporation; Daelim Industrial Co. LTD.; Indian Oil Corporation LTD.; Oil India LTD, Petroleos De Venezuela S.A.; and Sasol LTD. She said that due to the severity of the sanctions that the U.S.

and the world community have placed on businesses in Iran, many companies had withdrawn from Iran over the course of the past year, including a number of companies with which the OTT engaged. She said that the OTT also relied on the U.S. Government Accountability Office, which had been required to report to Congress on a periodic basis with respect to companies that continued to operate in Iran. Ms. McClure stated that the OTT would continue to engage with INA and Mitsui & Co. Ltd., companies that indicated they continued to do a limited amount of business in Iran in connection with prior contracts, to ensure they were making progress towards exiting from business relations with Iran.

With respect to Sudan, Ms. McClure reported that the OTT had engaged as a member of the Conflict Risk Network with Caterpillar, Inc., based upon the company's disclosure that its non-U.S. subsidiaries sold equipment to the Government of Sudan. Ms. McClure stated that the OTT planned to engage Caterpillar. She noted that Caterpillar's involvement in Sudan was through its subsidiaries, and the company took the position that it does not have control over the actions of its subsidiaries. However, she underscored that the OTT's position is that Caterpillar should exercise more control.

Corporate Governance Review

Francis Byrd, Assistant Treasurer for Policy, provided a report of the corporate governance activities for the quarter ended December 31, 2012, including proxy voting, indicating that there were 92 domestic meetings where 763 votes were cast, of which 27.39% were against management. He reported that there were 507 international meetings where 4,538 votes were cast, of which 17% were voted against management. Mr. Byrd said that during the quarter ended December 31, 2012, all of the international investment managers voted consistently with the CRPTF Global Proxy Policies. He said that the CRPTF domestic proxy votes for the quarter were posted on the Website.

Regarding the 2013 proxy season, Mr. Byrd discussed the OTT's sole filing that requested separation of the Chair and Chief Executive Officer ("CEO") position at The Walt Disney Company. Finally, Mr. Byrd reported that the CRPTF was a co-filer on a resolution filed with JP Morgan Chase which called for the separation of the Chairman and CEO roles, along with the American Federation of State, County and Municipal Employees, a public employees union; the New York City Comptroller for the New York City Retirement Systems and Pension Funds; and Hermes.

Presentation by and Consideration of Levine Leichtman Capital Partners V, L.P.

Terrence Purcell, Principal Investment Officer ("PIO"), provided opening remarks and introduced Levine Leichtman Capital Partners V, L.P. ("Levine Leichtman V" or "Fund V"), a private investment opportunity managed by Levine Leichtman Capital Partners ("Levine Leichtman" or the "General Partner"). He introduced Bradley Atkins, Chief Executive Officer of Franklin Park Associates, LLC, the CRPTF consultant for the Private Investment Fund

("PIF"). Mr. Purcell stated that Treasurer Nappier was considering an investment of up to \$75 million in Levine Leichtman V and noted that the fund had currently raised approximately \$525 million against a \$1.5 billion fund. Next, Mr. Purcell provided a brief history on Levine Leichtman, its investment strategy and geographic exposures.

Mr. Purcell commented on the CRPTF's previous commitment of \$75 million to Levine Leichtman Capital Partners IV, L.P. ("Fund IV") in 2008. He stated that as of September 30, 2012, Fund IV had generated a 27.1% net internal rate of return, which ranked it in the first quartile of private equity funds for its vintage year, and he noted that it had also distributed \$17.5 million of capital back to the CRPTF. Mr. Purcell remarked that in total, the General Partner had generated a gross internal rate of return of just over 20% per year for its four previous funds.

Presentation by Levine Leichtman Capital Partners, LLC

Levine Leichtman -- represented by Lauren Leichtman and Arthur Levine, founding partners -- made a presentation to the IAC. Ms. Leichtman introduced the team, provided a firm overview and highlighted Levine Leichtman's strategy. She said that the firm had invested almost exclusively in the lower end of the U.S. middle markets over the last 30 years.

Next, Mr. Levine discussed the middle market growth target market and commented on the investment opportunities and noted Levine Leichtman focused on companies where the existing management team wanted to purchase firm equity. Finally, Mr. Levine discussed Fund IV's investment track record, and its 17% annual cash yield.

Ms. Leichtman commented on the low correlation of Levine Leichtman's portfolio companies to U.S. GDP. Mr. Levine remarked that he expected the U.S. economy to be essentially flat over the next four to five years and that despite the flat economic environment, Levine Leichtman would find companies that would grow at 25% to 30% per year.

In response to Chairman Budnick, Mr. Levine said that Levine Leichtman focused on small or medium sized companies where the management team owned equity in the company. He described the difference between a leverage buyout strategy, which takes a control position in the company and is expected to build the business better than the existing management teams; versus Levine Leichtman's structured equity strategy that builds the business alongside the existing management teams and the founders. Next, Ms. Leichtman detailed Levine Leichtman's investment structure and Mr. Levine commented on the firm's market opportunities in the tightened capital markets. Finally, Ms. Leichtman discussed Levine Leichtman's seasoned team of middle market structured equity investment professionals. Thomas Fiore posed questions regarding the larger size of Fund V, to which Ms. Leichtman responded that the opportunity set was sufficient to support the fund size and that after extensive due diligence, Levine Leichtman expects to close on about four investments a year, each averaging about \$75 million.

Roll Call of Reactions for Consideration of Levine Leichtman Capital Partners V, L.P.

Mr. Freeman, Ms. Carpenter, Messrs. Murray, Hale and Fiore, David Himmelreich, Peter Thor, Joshua Hall, Carol Thomas and Chairman Budnick all supported an investment in Levine Leichtman V. Mr. Freeman added that he liked Levine Leichtman's philosophy and its track record was quite sound. Ms. Carpenter agreed with Mr. Freeman's comments and added they were a professional and focused team.

Chairman Budnick called for a motion to waive the 45-day comment period. **A motion was made by Mr. Freeman, seconded by Ms. Thomas, to waive the 45-day comment period for Levine Leichtman Capital Partners V, L.P. The motion was passed unanimously.**

Other Business

Chairman Budnick invited the IAC members to submit agenda items for the June 12, 2013 IAC meeting.

Comments by the Chairman

There being no further business, Chairman Budnick adjourned the meeting at 10:22 a.m.
This meeting was electronically recorded.

Respectfully submitted,



**CHRISTINE SHAW
DEPUTY TREASURER
for
DENISE L. NAPPIER
SECRETARY**

Reviewed by



**NEIL G. BUDNICK
CHAIRMAN**