

INVESTMENT ADVISORY COUNCIL
WEDNESDAY, May 9, 2007

MEETING NO. 344

Members present:

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

Absent:

Thomas Fiore, representing
Robert L. Genuario
David (Duke) Himmelreich

Others present:

Howard G. Rifkin, Deputy Treasurer
Susan B. Sweeney, Chief Investment Officer
Patricia DeMaras, Associate Counsel
Greg Franklin, Assistant Treasurer-Investments
Michelle Hale, Investment Officer
David Holmgren, Principal Investment Officer
Donald Kirshbaum, Investment Officer
Catherine E. LaMarr, General Counsel
Lee Ann Palladino, Principal Investment Officer
Jason Price, Investment Officer
Ronnie Rodriguez, Investment Officer
Linda Tudan, Executive Assistant to the Treasurer
Larry Wilson, Assistant Treasurer-Cash Management
Judy Balich, Executive Secretary

Guests:

Laura Backman, State Street Bank
Raudline Etienne, CRA RogersCasey
Harvey Kelly, Leumas Advisors
Jacquelyn Lyons, State Street Corporation
Julie Naunchek, CSEA-Retiree Council #400

Chairman Dick Roberts called the meeting to order at 10:35 A.M.

Approval of Minutes

Chairman Roberts asked for comments on the Minutes of the April 11, 2007 Investment Advisory Council (“IAC”) Meeting. David Roth asked that the section on the Morgan Stanley Prime Property Fund Roll Call reflect his qualification for approval of the investment, namely that he thought the Core real estate was an appropriate asset class and that Morgan Stanley was probably fine to manage that asset but in his opinion, the projected returns justified only a very reduced investment at this time because of the timing and that was the only approval he would make. George Mason indicated that also in this section, his comment about the investment should be corrected to read “commercial” real estate and not “core” real estate. Carol Thomas pointed out that on page two, the last paragraph, second sentence, “not” should be “noting”. Peter Thor said that on page six, the concern he expressed regarding Aldus Equity, LLC (“Aldus”) was inaccurate and he clarified his concern for the minutes indicating that it was not the engagement of Aldus with Wal-Mart that troubled him, but the fact that Aldus said that they were not aware of Wal-Mart’s general corporate behavior. **A motion was made by James Larkin, seconded by Ms. Thomas, that the Minutes of the April 11, 2007 IAC meeting be accepted with the edits as requested by Mr. Roth, Mr. Mason, Ms. Thomas and Mr. Thor. The motion was passed unanimously.**

Chairman Roberts said that there was a need to amend the agenda following the presentation by Independent Fiduciary Services, Inc. (“IFS”) to enter into Executive Session. Chairman Roberts asked for a motion to amend the agenda following the presentation by Independent Fiduciary Services, Inc. to enter into Executive Session. **A motion was made by Ms. Thomas, seconded by Mr. Larkin, to amend the agenda following the presentation by Independent Fiduciary Services, Inc. to enter into Executive Session.**

Opening Comments by the Treasurer

Treasurer Denise Nappier began her comments with remarks about Susan Sweeney, Chief Investment Officer (“CIO”), noting that this would be Ms. Sweeney’s last IAC meeting. She told the IAC members that Ms. Sweeney is the longest serving CIO in the history of the Office of the Treasurer (“OTT”), that the assets committed to the care of the Connecticut Retirement Plans and Trust Funds (“CRPTF”) have never been more robust and thanked Ms. Sweeney for her contribution to the OTT.

Treasurer Nappier updated the IAC on presentations made at the April meeting, beginning with KPS Capital Partners, LLC (“KPS”) which presented its Special Situations Fund III for consideration. She said that after considering the feedback from the IAC members, she decided to commitment up to \$75 million to this partnership, but that following the April meeting, the CRPTF was informed that KPS was accelerating its closing due to the heavy demand from limited partners. She explained that the fund would hold a closing on May 15 and a final close on June 1 and that if Connecticut made the May 15 closing, the CRPTF would be allotted \$50 million; if the CRPTF made the June 1 closing it would be allotted \$40 million; and after June 1,

the CRPTF's allotment would be zero. Treasurer Nappier indicated that PFM and legal counsel are working expeditiously to close this partnership commitment.

Treasurer Nappier said that after considering the feedback from the IAC members, she had decided to designate JER Europe Fund III, L. P. as a preferred international real estate manager with a commitment of up to \$35 million. She noted that during the meeting, several Council members expressed their concerns about Joseph Robert's support of non-traditional public schools as part of his charitable giving activities through his foundation, Fight for Children ("FFC"). Treasurer Nappier said that she did some research and determined that FFC supports Washington D.C. public schools, charter schools and independent schools, but that as part of the contract negotiations, she would ask that Mr. Robert meet with IAC union representatives so that he could learn more about opposing perspectives on supporting non-traditional public schools. She noted that from her perspective, a dialogue with a financial backer of charter schools would be more constructive than declining to make a commitment to an investment that she felt would be advantageous for the CRPTF. Treasurer Nappier said that Dave Johnson, Principal Investment Officer, would keep the IAC informed of Mr. Robert's response to this request.

Treasurer Nappier said that she made a decision on Morgan Stanley Prime Property Fund, LLC, an open-end commingled core real estate fund. She said that after considering the IAC feedback, she had decided to commit up to \$150 million, but with an initial commitment of only \$100 million and an option to fund an additional \$50 million during the 12-month period following the initial funding.

Treasurer Nappier reported that she had not yet made a final decision on the three fund-of-funds finalists that had presented last month for the management of the private equity portion of the Connecticut Horizon Fund. She said that she is still evaluating the firms and considering the IAC's feedback.

Treasurer Nappier provided some background on the Request for Proposal issued in January 2007 for consulting services, which covered three broad mandates of traditional investment consulting, "alternatives" investment consulting and organizational/operational consulting. She elaborated on "alternatives" noting that those could be commodities, portable alpha and hedge funds to name a few. Treasurer Nappier talked about the two days of interviews with the semi-finalists for each of the mandates, noting that the IAC members were invited to attend the meetings and that Dick Roberts, Jim Larkin and George Mason attended all of the sessions. She said that of the three mandates, she was still deliberating on which of the respondents to bring before the IAC for the traditional and alternatives investment consulting services. Treasurer Nappier said that of the two semi-finalists for the organizational/operational consulting services, she determined that there was one very strong candidate, Independent Fiduciary Services, Inc. ("IFS") based in Washington, D. C. Treasurer Nappier said that the organizational/operational study of the Pension Funds Management ("PFM") division was a project that she had wanted to pursue for several years now and that IFS had demonstrated a depth of experience and skill making it an easy decision to bring them in to present to the IAC.

Treasurer Nappier called attention to the two news clippings in the IAC package regarding the practices of other states in the world of divestments. She talked about Connecticut's position

with regard to Sudan legislation recounting that last May 2006, the Connecticut General Assembly passed legislation affirming the Treasurer's authority to divest and or prohibit investment in companies doing business in Sudan. She said that rather than mandating divestment or prohibition on investment, Connecticut's legislation endorses an engagement approach, inviting companies to open a dialogue with the OTT on their activities in Sudan and encouraging those companies operating in Sudan to act responsibly and avoid providing any support to governmental policies that may threaten human rights. Treasurer Nappier said that Connecticut's legislation enables divestment, but that she views divestment as a last resort, when engagement has failed or been rejected. She informed the IAC that her office has been working to engage several companies, many of which had cooperated and dialogue is ongoing, but that some companies failed to cooperate by either not responding to our inquiries or providing inadequate or inaccurate information, preventing her from performing her statutory and fiduciary duties. Treasurer Nappier then reported to the IAC her decision with regard to six companies that have significant business in Sudan, but which have refused to cooperate with the OTT's reasonable attempts to obtain information and open a dialogue with them. She said that she decided to divest the holdings of the CRPTF in China Petroleum and Chemical Corp., noting that the CRPTF held 12.4 million shares valued at \$11.9 million with a market value reflecting an unrealized gain of \$5.4 million. In addition, she said that she was prohibiting future investment in five companies in which the CRPTF currently holds no shares: Bharat Heavy Electricals, Ltd.; Nam Fatt Co. Bhd; Oil and Natural Gas Corp. Ltd.; PECD Group; and Sudan Telecom Co. Ltd. The Treasurer said that letters were sent to each of these companies as well as to the CRPTF managers to inform them of her decision.

Mr. Larkin asked if Treasurer Nappier planned a press release on the issue. Treasurer Nappier said there are no plans to do so, but would consider producing a release.

Treasurer Nappier asked Catherine LaMarr, General Counsel, to comment on the divestment legislation. Ms. LaMarr explained that there are two sets of laws with which the OTT was working to comply, one is a Federal statute that requires the CRPTF to avoid making investments with terrorist sponsored states and the other is an old law in the Connecticut statutes that requires divestiture in Iran with language that makes enforcement a real challenge. She said that the CRPTF managers, through contracts with the CRPTF, are required to evaluate investments as they relate to this law as well as several others. Treasurer Nappier added that the burden is placed on the CRPTF managers to track compliance.

Finally, Treasurer Nappier shared her decision to revive the Emerging Market Debt ("EMD") manager search. She said that in 2004 there were two candidates that presented to the IAC, PIMCO and Citigroup Asset Management (now Stone Harbor Emerging Markets), and that those two managers were selected as preferred vendors. She explained that due to organizational issues, contract negotiations with them were aborted by the CRPTF and the two firms were placed on "hold." Since that time, she said that the firms have been ranked by the CRPTF's consultant, RogersCasey, as "buy" and that while she would not now resume negotiations with these two firms, they would be invited to compete in an expedited search for the top EMD managers. Treasurer Nappier said that she asked RogersCasey to update the due diligence on all the "buy" rated EMD managers and present a written report with their recommendations on the semi finalists with a possible presentation at the July IAC meeting.

CRPTF Final Performance for March 2007

Ms. Sweeney reported that for the month of March the total fund outperformed the CMMI by 6 basis points, with most asset classes coming in close to their benchmarks. She said that for the three and five years, the fund was closely tracking the custom benchmark, trailing by just 25 and outperforming by 9 basis points, respectively, and for the seven years, the fund is 137 basis points ahead of the benchmark without manager objectives added in and exactly on the benchmark when manager objectives are factored in. Ms. Sweeney noted that the total assets stood at just over \$25 billion as of March 31, with equities comprising 63.7% of the total. She noted that these figures did not reflect a major rebalancing put in place at the end of April, in which the CRPTF liquidated slightly over \$1 billion of equities to bring the fund below its 60% equity cap. Ms. Sweeney indicated that the caveat here is that April was a huge month for the equities markets and the April books may close over the 60% cap. She reported that as of March 31, the domestic equity portfolio was basically flat to the benchmark's 1.04% advance and that for the past one year, the Mutual Equity Fund ("MEF") portfolio gained 9.84% versus 11.28% for its benchmark, a lag of 144 basis points. However, Ms. Sweeney noted that for the longer-term seven year period, the MEF has annualized 2.83% versus 1.65% for the Russell 3000, a 118 basis point relative outperformance. Moving on to the International Stock Fund ("ISF"), Ms. Sweeney noted an advance of 2.35% in March which, although robust, did trail by 44 basis points its customized benchmark which rose 2.79% in the same period. She reported that for past one year, the ISF portfolio gained 15.29% versus 17.96% for its customized benchmark, a lag of 267 basis points and for the longer-term seven year period, the ISF has annualized 7.41% versus 6.27% for its benchmark, a 114 basis point relative outperformance. Ms. Sweeney said that the fixed income portfolio returned 14 basis points in March, exactly tracking its custom benchmark.

Presentation by Independent Fiduciary Services, Inc.

Treasurer Nappier provided introductory remarks relative to the need for a long overdue organizational assessment of the Treasury's PFM division and what is expected to be accomplished. She detailed some of the issues that would be reviewed by the consultant and the experience that IFS has had in conducting similar reviews for other states pension funds. Ms. Sweeney noted that this study would also address Ms. Thomas's staffing update issue that has been on the Request Status Report for some time now.

Presentation by Independent Fiduciary Services, Inc.

IFS made a presentation to the IAC on its qualifications for conducting an organizational/operational review of PFM. IFS was represented by Jenna Cullins, Managing Director and Senior Vice President and Vice Presidents Phyllis Taylor and Barbra Byington. Ms. Byington provided an overview of the firm, the history of the firm and the firm's business model. Ms. Cullins discussed the firm's diversity principles, corporate citizenship, competitive advantages and experience. Ms. Taylor talked about the firm's scope of work and report methodology.

Following the presentation by IFS, IAC members asked about circumstances under which IFS is retained as an independent fiduciary; the anticipated length of time required to accomplish an

evaluation of the PFM division; and the compensation analysis that would be conducted during the evaluation. The questions were answered by Ms. Cullins.

Roll Call of Reactions for Independent Fiduciary Services, Inc.

Ms. Thomas asked if she could look through the Oregon evaluation done by IFS and said that she was comfortable with retaining IFS. Mr. Roth said that he was very confident that IFS has the skills necessary to accomplish the evaluation. Sharon Palmer said that IFS was impressive and that she was comfortable with the firm. Mr. Thor said that he supported retaining IFS. Mr. Mason said that he was very impressed initially and just as impressed today and thought IFS would be very good for the project. William Murray said he felt that the experience of IFS was in the right area and supported retaining the firm. Michael Freeman said that he had no reservations in retaining IFS. Mr. Larkin said that he enthusiastically supported retaining IFS. Chairman Roberts said that he thought they were terrific, just what is needed and would be very helpful to the OTT.

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

Chairman Roberts asked for a motion to adjourn the Regular Session and enter into Executive Session for the purpose of discussing personnel issues. **A motion was made by Mr. Larkin, seconded by Mr. Thor, that the Investment Advisory Council adjourn the Regular Session at 11:45 a.m. and enter into Executive Session for the purpose of discussing personnel matters. The motion was passed unanimously.**

Those present for the Executive Session were Chairman Roberts, Treasurer Nappier, Ms. Thomas, Ms. Palmer, Mr. Roth, Mr. Thor, Mr. Mason, Mr. Murray, Mr. Freeman, Mr. Larkin and Deputy Treasurer Rifkin.

Chairman Roberts asked for a motion to adjourn the Executive Session and enter into Regular Session. **A motion was made by Mr. Freeman, seconded by Ms. Thomas, that the Investment Advisory Council adjourn the Executive Session at 12:20 p.m. and enter into Regular Session. The motion was passed unanimously.**

Chairman Roberts noted that no votes were taken during the Executive Session.

For the record, Treasurer Nappier informed the IAC that she appointed Lee Ann Palladino to serve as Acting Chief Investment Officer. She said that Ms. Palladino is the portfolio manager for the \$5 million Short Term Investment Fund and was doing a great job. Treasurer Nappier went on to provide Ms. Palladino's experience and expressed her gratitude to Ms. Palladino for her willingness to serve as the CIO during the nationwide search for a permanent CIO.

Chairman Roberts asked for a motion to endorse the selection of Lee Ann Palladino as Acting Chief Investment Officer. **A motion was made by Mr. Larkin, seconded by Ms. Palmer, to**

endorse the selection of Lee Ann Palladino as Acting Chief Investment Officer. The motion was passed unanimously.

Other Business

Status Report on Requests by IAC Members

Ms. Sweeney noted that the request for **Staffing Support** would be removed due to the operational/organizational survey that would be conducted.

Discussion of preliminary agenda for June 13, 2007 IAC meeting

Ms. Sweeney said that the June 13 meeting would be a quarterly meeting and would include a Securities Lending presentation.

Chairman Roberts asked Judy Balich to check with the auditor, Thomas Willametz, regarding a possible Audit Sub Committee meeting in June.

Mr. Freeman said that he wanted to publicly thank Treasurer Nappier for meeting with students in Stonington, Connecticut.

There being no further business, the meeting was adjourned at 12:35 PM.

An audio tape of this meeting was recorded.

Respectfully submitted,


DENISE L. NAPPIER
SECRETARY