

**INVESTMENT ADVISORY COUNCIL
WEDNESDAY, July 9, 2008**

MEETING NO. 357

Members present:

Thomas Barnes***
Thomas Fiore*, representing Robert Genuario
Michael Freeman
David (Duke) Himmelreich
James Larkin, Chairman
William Murray**
Denise L. Nappier, Treasurer
Sharon Palmer*
Carol Thomas
Peter Thor

Absent:

David Roth

Others present:

Howard G. Rifkin, Deputy Treasurer
Linda Hershman, Assistant-Deputy Treasurer/Chief of Staff
Lee Ann Palladino, Acting Chief Investment Officer
Joanne Dombrosky, Principal Investment Officer
Gregory Franklin, Assistant Treasurer-Investments
David Holmgren, Principal Investment Officer
Wayne Hypolite, Executive Assistant
David Johnson, Principal Investment Officer
Catherine LaMarr, General Counsel
Shelagh McClure, Director of Compliance
Meredith Miller, Assistant Treasurer-Policy
Christine Palm, Communications
Jason Price, Principal Investment Officer
Linda Tudan, Chief Executive Assistant
Christina McGinnis, Executive Secretary
Winifred (Winnie) Scalora, Administrative Assistant

Interns:

Julian Borges, Office of the Treasurer
Darrell Kee, Office of the Treasurer
Amy Kelbick, Office of the Treasurer
Nicole Lawton, Office of the Treasurer
Glendon Llewellyn, Office of the Treasurer
Michael Noble, Office of the Treasurer
Andrew Pels, Office of Policy and Management
Adam Stanistic, Office of the Treasurer
Mollie Sullivan, Office of the Treasurer

Guests:

Benjamin Adams, The Townsend Group
Bradley Atkins, Franklin Park

* Arrived at 9:15 A.M.

** Arrived at 9:22 A.M.

*** Arrived at 9:32 A.M.

Joseph Barcic, Mercer Investment Consulting
Steven Burns, The Townsend Group
Robyn Kaplan-Cho, Connecticut Education Association
Harvey Kelly, Leumas Advisors
Jacqueline Lyons, State Street Bank
Julie Naunchek, CSEA-Retiree Council #400
Dashka Slater, Comcast

Chairman James Larkin called the Investment Advisory Council ("IAC") Meeting to order at 9:06 A.M.

Approval of Minutes

Chairman Larkin stated that based on discussion with Treasurer Denise Nappier and Shelagh McClure, Director of Compliance, there is an edit to the Draft of the Minutes for the June 11, 2008 IAC Meeting. He said that within the section entitled "CRPTF Sudan Initiative," in the second from last sentence, the word "potentially" needed to be added so that the Minutes read as follows: "...Treasurer Nappier has decided to send a letter to Petroliam Nasional Bhd (Petronas) informing them of the intention to potentially divest from any holdings.... Chairman Larkin then asked for further comments on the Minutes of the June 11, 2008 IAC meeting. **There being no comments, a motion was made by Michael Freeman, seconded by Duke Himmelreich, that the Minutes of the June 11, 2008 IAC meeting be accepted as amended with the word "potentially" added on the third page. The motion was passed unanimously.**

Comments by the Treasurer

Treasurer Denise Nappier began her opening comments by acknowledging the 2008 interns and noting their varied college majors including Political Science, International Studies, Business, Communications, Accounting and Finance. She discussed the importance of the Intern program and the goal of exposing these talented young individuals to the business of the Treasury.

Before discussing today's agenda, Treasurer Nappier reported that after considering the feedback from the IAC, the consultant, and the due diligence process, she had decided to make a \$100 million commitment to **Welsh, Carson, Anderson and Stowe Fund XI ("WCAS XI")**, pending successful contract negotiations. She further noted that WCAS XI would focus on making controlled investments in growth-oriented companies within the health care and information/business services industries.

Treasurer Nappier stated that this is the first IAC meeting of Fiscal Year 2009 and while Fiscal Year 2008 was productive for the management of the Connecticut Retirement Plans and Trust Funds ("CRPTF"), it took place during one of the most turbulent markets in recent history and ultimately affected the performance of the pension fund. She reported that at this time last year, the pension fund returned an impressive 17.34% representing the fifth consecutive year of positive returns. Treasurer Nappier then informed the members of the IAC that in reviewing the performance results for the period ended May 31, 2008 and given the performance of the global

equity markets during June, there was a high probability of ending the fiscal year with a negative overall performance. She continued that it was already reported that U.S. based pension funds would likely realize more than a 5% loss during the 2008 fiscal year. Treasurer Nappier stated that during this past fiscal year the CRPTF's relative performance was above the benchmark, and that for the fiscal year ended June 2008, the CRPTF remained on course to fare better than the benchmarks, reflecting a prudent defense of posturing the portfolios in down markets. She said that the accomplishments of Fiscal Year 2008 would be highlighted and presented in the Treasurer's Annual Report and discussed at a future IAC meeting.

Treasurer Nappier then disclosed that under the terms of the Office of the Treasurer ("OTT") the contract with the CRPTF's currency overlay provider, Bank of New York ("BNY") Overlay Associates, had been assigned to another wholly-owned subsidiary of BNY Mellon; BNY Mellon Pareto ("Pareto"). She further stated that during June, the BNY Overlay Associates' two lead portfolio managers gave notice that they would leave BNY Mellon at the end of July 2008, adding that after assessing the options, the OTT chose to assign the contract to Pareto. Treasurer Nappier commented that the Pareto team is a compatible fit to the CRPTF's objectives and would be capable of managing the overlay program as outlined in the investment guidelines. She said that the Pareto team had previously presented to the IAC when vetted earlier by the CRPTF as a currency manager semi-finalist in the original Request for Proposal ("RFP") process.

Turning to today's agenda, Treasurer Nappier stated that a presentation on the project plan for a private investment consultant search would be provided. She added that the contract with the current private investment consultant, Franklin Park, would expire in July 2009 and in accordance with the State's procurement policy this contract must be put out for competitive bid. Treasurer Nappier stated that the CRPTF's new real estate investment consultant, The Townsend Group ("Townsend"), would present its first Real Estate Fund ("REF") report for the quarter ended March 31, 2008. She then reported that New England Pension Consultants, the CRPTF's alternative investment consultant, began working with Pension Fund Management in June on the Alternative Investment Fund. Finally, Treasurer Nappier stated that quarterly reports would be presented today on the Domestic Equity Brokerage ("DEB") program and Corporate Governance.

Chairman Larkin stated that Treasurer Nappier's comments for the 2008 fiscal year were informative and agreed with her assessment on the projected CRPTF performance results.

CRPTF Final Performance for May 2008

Lee Ann Palladino, Acting Chief Investment Officer, highlighted some of the key financial events that occurred over the past year in relation to the credit crisis and discussed where the CRPTF was a year ago, where it is today and how this impacted the strategic implementation of the CRPTF's asset allocation and its performance. She commented specifically on the asset-backed and mortgage-backed securities markets, and stated that there had been a permanent shift of the risk premium on all credit products. Duke Himmelreich asked whether the Core Fixed Income Fund performance was down due to unrealized market value or because of defaults. Ms.

Palladino stated the performance was mainly attributable to unrealized losses associated with marking securities to market.

Ms. Palladino next reported on how the credit crisis affected the financial institutions. She commented that the impact of the financial crisis permeates the entire market, particularly affecting entities that utilize leverage. Ms. Palladino noted that as the 2008 fiscal year unfolded other entities were also impacted, such as insurers like MBIA and government-sponsored entities, Fannie Mae and Freddie Mac.

Ms. Palladino stated that, in summary, as the markets began to dislocate a year ago, there was much concern and uncertainty about the future outlook; but while uncertainty still remained today, many of the credit issues have been quantified and markets were beginning to settle. Nonetheless, she stated that the culmination of these events impacted the growth of the economy. Ms. Palladino added that with the economy slow down and shrinking profit margins, the stock markets declined about 20%, peak to trough, which potentially signifies a bear market.

Ms. Palladino reported that for the 2008 fiscal year, while a volatile and difficult market to date, the performance of the CRPTF in relationship to its benchmark had been strong. Reiterating Treasurer Nappier's point, she said the CRPTF's success was based on the fact that the asset classes were diversified; however, because all of the markets reacted so harshly, both in the U.S. and internationally, negative results would likely be posted for this fiscal year, even though results may be above the benchmark. Further, Ms. Palladino stated that the longer-term horizon performance of the CRPTF had actually improved as a result of the CRPTF's lower risk profile, the fact that the CRPTF had strictly adhered to its asset allocation targets and its allocation to the alternative asset classes.

Ms. Palladino reviewed the State Employees' Retirement Fund ("SERF"), noting that the SERF outperformed its benchmark for every time horizon over the last three years, with the exception of the three-month horizon. She stated that performance in the longer horizon had continued to strengthen. Ms. Palladino said that because the emerging market equity and inflation-linked bond money manager searches have not been completed, the SERF remained under policy ranges in these funds. She reported that last month the IAC approved modified investment policy targets for the six plans and those targets would be included in the June 30, 2008 reports.

Regarding the Teacher's Retirement Fund ("TERF"), Ms. Palladino reported a market value of \$15.3 billion; all of the performance horizons were positive to the benchmark with the exception of the three-month horizon. She noted that \$2 billion of the Pension Obligation Bond was invested, and reviewed the rebalancing of the assets, which took place in May.

Ms. Palladino reviewed the Municipal Employees' Retirement Fund ("MERF") and reported a market value of \$1.7 billion. She stated that the MERF did not meet its benchmark of 10.68% for the longer term five-year horizon returning 10.17%, and noted that this plan has a different asset allocation going forward than the SERF and TERF.

Treasurer Nappier commented that the current market environment impacted other areas of the OTT that dealt in the financial markets, including debt management and cash management. With respect to debt management, she noted that the Treasury had minimal exposure to auction rate securities and the Debt Management Division effectively managed to cap borrowing rates at low interest levels; unlike some entities whose resets increased to double digits interest rates. Regarding the Short Term Investment Fund, Treasurer Nappier cited that there was some exposure to mortgage-backed securities in its Cheyne Finance position, which went into receivership last year. She noted that Cheyne Finance had been carried at 87 cents on the dollar and that the CRPTF received an \$18 million distribution bringing its initial \$100 million investment to \$82 million. Treasurer Nappier discussed the upcoming auction of Cheyne Finance and noted that the reserve fund would be available to cover any potential losses.

Consideration of the Private Investment Consultant Search Project Plan

Jason Price, Principal Investment Officer, provided a project plan timeline and screening/selection criteria for the Private Investment Fund consultant search. He reported that the contract with Franklin Park Associates, LLC, was due to expire on July 31, 2009. Mr. Price noted that on July 21, 2008 the RFP, which outlines the search process, was scheduled to be issued. He stated that once the information had been gathered and analyzed, the semifinalists would tentatively be interviewed during the week of November 17, 2008 and that the members of the IAC would be invited to participate in this process. Mr. Price said that the final candidate(s) would be presented to the IAC at the December IAC meeting.

Chairman Larkin asked how many organizations would likely respond to the RFP. Treasurer Nappier added that past experience indicates that there would probably be only three to four qualified candidates. Chairman Larkin requested comments from the IAC members regarding the plan. **There being no comments, Chairman Larkin then asked for a motion to endorse the plan. Carol Thomas entered a motion to endorse the plan. Mr. Himmelreich seconded the motion. The motion to endorse the plan was passed unanimously.**

Domestic Equity Brokerage Program Report as of March 31, 2008

David Holmgren, Principal Investment Officer, reported on the DEB program as of March 31, 2008. He stated that this was one of Treasurer Nappier's initiatives dating back to 2002. Mr. Holmgren then reported that, since inception of the program, the total DEB commissions generated were nearly \$21.7 million. He added that this has been a cost-effective program with the current average commissions paid at approximately 1.9 cents per share. Mr. Holmgren explained that the breadth of the program was far reaching and included 65 broker/dealers who received DEB business from the CRPTF's managers this quarter. He then provided a breakdown of the program on a dollar basis both quarterly and since inception. Mr. Holmgren stated that 52.8 million shares were traded by the CRPTF's managers during the quarter and that 50% of every commission dollar traded was executed within the initiative.

An IAC member asked what the peers are paying in comparison to the 1.9 cents commission. Mr. Holmgren provided a commissions cost analysis summary from Elkins/McSherry, a trading

analytics firm, showing that commissions average between 2 and 4 cents for large plans and that electronic trading continued to drive the commission costs down.

Real Estate Fund Review as of March 31, 2008

Steve Burns, Principal, and Benjamin Adams, Consultant, of Townsend, reported on the REF. Mr. Adams reported on the REF portfolio's size and composition along with its performance for the quarter ended March 31, 2008, and Mr. Burns reported on expected market conditions which would affect the REF. Mr. Adams stated that the REF portfolio stands at about \$943 million and is spread among 26 separate investments managed by 17 distinct managers. Mr. Adams said the quarter turned out quite well with a portfolio net return of 3.0% versus the NCREIF Property Index ("NCREIF") index of 1.6%, but it was largely event driven. He also said that the portfolio had an additional \$344 million that remains committed but unfunded so the REF is well positioned to confront a down cycle in the market and to buy near the bottom.

Mr. Adams reported that the 1.6% total return for the NCREIF Property Index was comprised of an income component of 1.26% and an appreciation component of 34 basis points. He said the one-year return for the NCREIF was 13.6%. An IAC member questioned the ability to measure appraisals and appreciation for the quarter. Mr. Burns responded that the underlying managers have appraisal policies in place with most managers appraising each asset on a quarterly basis.

Mr. Adams noted that, consistent with the decrease in transaction volume in the U.S. due to credit conditions, activity within the portfolio's funds was muted; 95% of the portfolio's ending market value was invested in U.S. markets and 5% in non-U.S. markets. Discussion ensued about the REF distributions and future reporting from Townsend and Mr. Burns responded satisfactorily to several questions from IAC members.

Corporate Governance and MacBride Compliance Review as of March 31, 2008

Meredith Miller, Assistant Treasurer-Policy, provided a report on Corporate Governance and MacBride Compliance for the quarter ended March 31, 2008. She stated that there were 429 domestic proxies cast on behalf of the CRPTF with 37% voted against management; with respect to the international proxies, 400 were cast with 9.4% against management. She also noted that all the managers were in compliance with the international proxy voting policies as well as the MacBride state law. Ms. Miller stated that since the last report, Treasurer Nappier spearheaded a communication to the Securities and Exchange Commission ("SEC"), along with 21 other institutional investors, accounting for \$1.4 trillion in assets, calling for expanded disclosure on the independence of compensation consultants, which was formally put on the docket as a petition for rule making at the SEC. Ms. Miller reported that three new SEC members were confirmed last week by Congress and Treasurer Nappier would be working with the SEC on the compensation consultant issue along with a number of issues the OTT has been pressing with the SEC over the last few years.

Ms. Miller provided an overview of what will be reported during the next IAC Meeting and what the Policy Division of the OTT would be working on over the next year for Corporate

**INVESTMENT ADVISORY COUNCIL
WEDNESDAY, July 9, 2008**

7

Governance. Finally, she stated that both presumptive presidential candidates for the major parties were supporting a policy on say on pay to allow an advisory vote by shareholders on the executive compensation package of a company and both also support a legislative fix to limits to carbon emissions.

Chairman Larkin stated that the Connecticut Office of the State Treasurer has been in the forefront in addressing governance issues and MacBride.

Comments by Chairman Larkin

Chairman Larkin asked the eight interns to stand. He thanked them all for their hard work and stated that he hopes they are all motivated to achieve by seeing the incredible achievements of the members of the State Treasury. Chairman Larkin announced that there will not be an IAC meeting during the month of August.

Other Business

Discussion of preliminary agenda for September 10, 2008 IAC meeting

Mr. Larkin invited IAC members to submit agenda items for the September 10, 2008 meeting. There being no further business, the meeting was adjourned at 10:38 a.m.

An audio tape of this meeting was recorded.

Respectfully submitted,



**DENISE L. NAPPIER
SECRETARY**

Reviewed by



**JAMES T. LARKIN
CHAIRMAN**