INVESTMENT ADVISORY COUNCIL
WEDNESDAY, DECEMBER 10, 2003

MEETING NO. 310

Members present:	Clare Barnett Thomas Fiore, representing Marc S. Ryan Denise L. Nappier, Treasurer Sharon Palmer Henry E. Parker Clarence (Dick) L. Roberts, Jr., Chairman David Roth Rosalyn Schoonmaker Carol Thomas
Members absent:	Reginald Martin
Others present:	Howard G. Rifkin, Deputy Treasurer Susan B. Sweeney, Chief Investment Officer Catherine E. LaMarr, General Counsel Gregory Franklin, Assistant Treasurer-Investments Meredith Miller, Assistant Treasurer-Policy Gary Draghi, Principal Investment Officer Guy Garcia, Principal Investment Officer Harold W. Johnson, Principal Investment Officer David Scopelliti, Principal Investment Officer Bernard Kavaler, Director of Communication Pamela Bartol, Assistant Investment Officer
Guests:	Sean Quigley, State Street Corporation Raudline Etienne, CRA RogersCasey Cynthia Steer, CRA RogersCasey Matthew McCormick, CRA RogersCasey Juan Prieto, CRA RogersCasey Alex Sviridov, CRA RogersCasey Mary Frances Kelley, INVESCO Private Capital Jeff McKenzie, Andreder Hirschhorn & Co. Harvey Kelly, Leumas Advisors Julie Naunchek, CSEA-Retiree Council #4 Robyn Kaplan-Cho, Connecticut Education Association Marc Weiss, Pension Consulting Alliance

Chairman Dick Roberts called the meeting to order at 9:20 A.M.

Approval of Minutes

The Minutes of the October 23, 2003, Investment Advisory Council meeting were discussed. Chairman Roberts asked if there were any comments on the Minutes. Henry Parker clarified his comments regarding Mercer on Page 7, paragraph 3, sentence 6. After some discussion, Treasurer Denise Nappier suggested adding, "who had been retained to consult with the IAC on governance matters" to the end of that sentence. Mr. Parker agreed that this addition would resolve his concern. Carol Thomas said that on Page 4, paragraph 2, the third sentence was not clear. It was agreed that "that asset class" would be changed to "the Mutual Equity Fund." Ms. Thomas also noted that in sentence 4 of the same paragraph, "determine" needed to be changed to "determined." **A motion was made by David Roth, seconded by Ms. Thomas, that the Minutes of the October 23, 2003 IAC meeting be accepted as amended. The motion was passed unanimously with one abstention by Rosalyn Schoonmaker who had not been present at the October meeting.**

Opening Comments by the Treasurer

Treasurer Nappier said the hot topic is the ongoing investigation within the mutual fund industry and how the Connecticut Treasury is responding to allegations and admissions of impropriety. She said that in the agenda package, Agenda Item #8 from RogersCasey, there are descriptions of improper market conduct currently under investigation, which is known as market timing and late trading. Treasurer Nappier informed the IAC that the Connecticut pension fund does not invest in any mutual funds, but many managers with which CRPTF does business have mutual fund arms, so the Treasurer's office is taking steps to confirm that no improper activity took place in CRPTF's accounts. She also said there is a concern about the broad implication of the firms' reputations and stability over the long term and that CRPTF's consultants have sent a questionnaire to all investment managers and are in the process of reviewing their responses. Treasurer Nappier said one of the first firms to be charged was Putnam, which was recently hired as one of CRPTF's International Stock Fund managers with an allocation of approximately $290 million in an active core mandate. She stated that since the charge, Putnam has settled with the Securities and Exchange Commission ("SEC") and state regulators in Massachusetts an allegation that involved several portfolio managers who were purchasing shares in an international stock fund portfolio for their personal accounts at the same time they also managed those portfolios on behalf of investors. She said that these activities were discovered approximately three years ago by Putnam's compliance unit, but no disciplinary actions were taken at that time. Treasurer Nappier said that in October key personnel involved in this improper marketing activity were terminated and the settlement with the SEC ensures that Putnam will cease activity of this kind and will strengthen its compliance unit, and that restitution will be made to those investors directly affected by the trading activity. She said that a number of institutional and individual investors terminated their Putnam accounts immediately, but she has chosen to take a strategic approach to the situation by placing Putnam on the watch list; reviewing the fund to insure that the CRPTF's funds were not in any immediate danger; and beginning a comprehensive due diligence process that is still ongoing. She mentioned some of her specific concerns about Putnam, such as organizational stability, personnel turnover and fund performance. Treasurer Nappier, General Counsel Catherine LaMarr, and Chief Investment Officer Susan Sweeney met with the new CEO and other executives of Putnam on November 26, 2003 to determine the course that Connecticut would take. Treasurer Nappier informed Putnam that CRPTF has been harmed because last August in final contract negotiations with Putnam, Putnam failed to inform CRPTF that two of the portfolio managers had been cited for improper marketing activity about three years ago. She said that a major concern was that the creator of the product in which CRPTF is invested was one of the key personnel terminated by Putnam. Treasurer Nappier said that during the meeting, Putnam's CEO made a convincing argument that it would be in Connecticut's best interest to continue to do business with Putnam. Treasurer Nappier said that the due diligence process will continue and that she re-negotiated Putnam's management fees for the first quarter, which saved the Treasury $225,000. She also negotiated for a performance-based fee until March 2004, which means that if there are any fund performance issues Connecticut will not pay for them and by that time the due diligence will probably be complete and the Treasury should have a good perspective on whether or not Putnam's international stock fund product and the firm can survive. Treasurer Nappier emphasized that Connecticut has the right to terminate Putnam at any time and Putnam is still on the watch list.

Treasurer Nappier said that since the announcement about Putnam, there have been several other fund managers that have come under scrutiny by regulators, the SEC, the Attorney General of New York and the Secretary of State of Massachusetts. She said INVESCO has been charged with market timing, which had been allowed in various accounts contrary to the firm's prospectus. She also advised that INVESCO Capitol Management was recently hired by CRPTF to manage $270 million in assets. Treasurer Nappier spoke with the president of INVESCO, John Rogers, who oversees all of the INVESCO funds, and is proceeding with due diligence on INVESCO. She said INVESCO contends that it has done nothing wrong and is challenging the allegations, which could lead to a long, protracted litigation and it could severely harm the firm.

Treasurer Nappier said MFS, another recently hired fund, was indicted yesterday, December 9, 2003, for a similar activity. She said it appears that the firm's conduct might be more egregious than INVESCO's or Putnam's. She also said that MFS has prospectus that clearly states that there shall be no market timing activities and that is precisely what did take place at MFS and consequently the charge is fraud. Treasurer Nappier has not had the opportunity to speak with the CEO of MFS.

Treasurer Nappier said that each situation would be addressed on a case-by-case basis because each manager has its own unique situation, as is CRPTF's relationship with each manager. She emphasized that the position taken with Putnam was prudent and will protect CRPTF's funds and if there is any reason to believe that the funds are in imminent danger, CRPTF will terminate the relationship.

Mr. Roth asked if the Treasurer's office has a position on doing business with managers who allow or have an ambiguous position on market timing. Mr. Roth felt those managers are taking advantage of their investors. Treasurer Nappier said there is no real common definition of market timing but it is starting to be regulated. Ms. Sweeney added the SEC itself has not yet defined market timing. Treasurer Nappier said that as firms are being charged, they are ceasing the activity and that the regulators are on top of that issue now. Deputy Treasurer Howard Rifkin said there are also class action suits being brought against some of the funds on behalf of mutual fund shareholders. Mr. Parker noted that contracts should contain a clause that gives the State of Connecticut the advantage in cases where a manager violates laws or regulations. Treasurer Nappier explained that in the case of these mutual fund scandals, the assets are liquid and CRPTF can terminate at any time. She said one concern she has is how thorough the due diligence is before a contract is signed. She said that there are ways to strengthen the due diligence but that honesty cannot be legislated. Mr. Parker stated that there should be something in the contract that would give Connecticut the advantage in the event of an unexpected violation of regulations. Ms. LaMarr responded that each contract clearly states that if there is any violation of state or federal law or regulation or breach of fiduciary duty, Connecticut may terminate the contract for breach of contract.

Treasurer Nappier said she was pleased to give each member of the IAC the Annual Report for fiscal year 2003.

Treasurer Nappier informed the IAC that there would be presentations by three inflation linked bond managers later at the meeting. She said that approximately $190 million will be allocated to this mandate and one or two managers that present today will be selected. She said that next month there will be presentations on emerging market debt, another part of the fixed income fund structure, and anticipates approximately $570 million will be allocated to that mandate. Treasurer Nappier said there will also be two Private Equity Fund presentations today and, if all goes well, they will be the first new relationships in the private equity fund for Connecticut in the past five years. She said since Connecticut reentered the private equity market approximately one and a half or two years ago, commitments have been made to three of the CRPTF's existing managers but this will add new general partners. Treasurer Nappier said that Pension Consulting Alliance ("PCA"), the real estate consultant, will also make a presentation today on the strategic implementation plan for becoming active investors in the real estate market.

Chairman Roberts announced some changes in the order of agenda items to accommodate a plane schedule of one of the presenters. After Agenda Item #6, Agenda Item #9 will be presented and Agenda Item #7 will be combined with Agenda Item #10.

Approval of Treasurer's Adopted Investment Policy Statement Regarding Currency Hedging

Ms. Sweeney indicated that at the last meeting there was a discussion on the Investment Policy Statement ("IPS") language for currency hedging that would allow that activity. She indicated that the language was agreed upon and was posted on the web site in accordance with Connecticut State Statutes for the requisite notice period and, as part of the posting, the Treasurer publicly concurred with the IAC comments discussed at the meeting. Ms Sweeney also indicated that the document before the IAC is the Treasurer's adopted version of the IPS language for currency hedging and the last process in this step is IAC approval of the Treasurer's adopted language. Ms. Sweeney read the insertion in Part I, Article VI, Use of Derivatives, as adopted "There shall be no foreign currency speculation or any related investment activity, with the exception of currency hedging managers who will be guided by specific risk parameters in their contracts." Chairman Roberts asked if there was any discussion or comments. **A motion was made by Ms. Schoonmaker, seconded by Clare Barnett, that the Investment Advisory Council approve the Treasurer's adopted Investment Policy Statement regarding currency hedging. The motion was passed unanimously.**

CRPTF Final Performance for September and October 2003

Ms. Sweeney reported on the final CRPTF performance for September and October. She said for the quarter ending September 30 the fund slightly underperformed its benchmark by approximately 48 basis points and that was mostly due to international equity. She said there was a slight underperformance in real estate, out-performance in mutual equity by 26 basis points and fixed income by 13 basis points. Ms. Sweeney also reported that private equity outperformed both Venture Economics All Private Equity Index ("Venture Economics Index") and the S&P 500. She explained that one of the industry benchmarks for this asset class is Venture Economics Index but that Venture Economics Index does not report monthly, but only quarterly. Ms. Sweeney reported that because the S&P 500 and Venture Economics Index were very close in the quarter ended September 30, private equity performance did not significantly affect overall performance. The reason for this is that the computation of the total fund benchmark uses the S&P 500 as a surrogate for the private equity because of the fact that Venture Economics Index is only calculated on a quarterly basis. She said the calendar year-to-date and the one-year shows a significant underperformance for the fund as a whole of 413 basis points and 754 basis points respectively. She also said this is largely attributable to the disparity between Venture Economics Index and the S&P 500. Ms. Sweeney said that again in the longer term Venture Economics Index and S&P 500 are very close and the numbers as a whole for the three-year and five-year were outperforming by 194 basis points and 153 basis points respectively. She reported on the TUCs ranking that shows CRPTF came in 59th percentile ranking for the quarter and slipped to 82nd and 86th for the calendar year to date and the one-year rankings. She also noted, however, that the longer term performance was stronger, with the fund's three year rank at the 54th percentile and the 25th percentile for the past five years. Ms. Sweeney said State Street has an analytical group that is trying to provide CRPTF with more information on TUCs, i.e., the construction of TUCs, and analysis on CRPTF's deviations from the universe. She met with State Street on November 8 and is waiting for answers to a number of questions. Ms. Sweeney mentioned that on the quarterly TUCs ranking there is an unusual anomaly in that the spread between the top ranked and the bottom ranked funds is quite narrow, at about 300 basis points.

Ms. Sweeney reported that in October the total fund underperformed the benchmark by 94 basis points, driven in part by the private equity. She said that mutual equity outperformed by 4 basis points; International Stock Fund and Fixed Income Fund underperformed by 27 basis points and 9 basis points respectively.

Treasurer Nappier noted that fixed income was down by 29 basis points and private equity was down by 3 basis points and there is a 29% exposure to fixed income versus a 9.9% exposure to private equity.

Mr. Roth asked Ms. Sweeney what the fixed income allocation within the asset class is. He noted that in the index to which CRPTF is compared, the breakdown is 73% in Lehman Aggregate, 17% High Yield and 10% Emerging Bond. Mr. Roth asked what the CRPTF breakout is within fixed income. Ms. Sweeney responded that 29% will be allocated to fixed income under the new structure with 20% core fixed income, 1% in inflation linked bonds, 5% in high yield and 3% in emerging market debt.

<u>Inflation Linked Bonds</u>

Ms. Sweeney announced that there are three managers who will be making presentations to the IAC. She said that presentation materials were distributed with the IAC meeting packages. The first manager is Brown Brothers Harriman.

Presentation by Brown Brothers Harriman

Brown Brothers Harriman ("BBH" or "Brown Brothers") made a presentation to the IAC regarding its inflation indexed securities. Brown Brothers was represented by Jeffrey Schoenfeld, Partner and Chief Investment Officer; Glenn Baker, Managing Director of Fixed Income Management; and John Nelson, Managing Director and Director of Institutional Relationship Management. Their presentation included an overview of Brown Brothers and the firm's fixed income business, the firm's institutional fixed income philosophy, process, strategies and performance.

Ms. Thomas noted that CRA RogersCasey provided the IAC with information that the average annual portfolio turnover is 300% and that the weighted average duration is at the low end of the benchmark. Ms. Thomas said that she would like comments on that strategy and how it relates to a market where interest rates are expected to begin to rise. Mr. Baker responded with an explanation of the various strategies that BBH applies throughout the year as the auction cycle occurs on a quarterly basis and as certain news influences the market and moves interest rates. He said that it has been BBH's experience that two or three times a year there are market dislocations due to the new treasury inflation protected securities ("TIPS") issuance and seasonal activity so that a turn over of that magnitude is about what has been required in order to generate the excess return. He noted that BBH only makes transactions in the portfolio to the extent that after all transaction costs, there is a benefit to the client. He said the maturity structure currently is actually shorter than market benchmark, driven primarily by two things, the approach of auction time when as new paper comes to market it puts upward pressure on inflation indexed yields and the economic climate.

Tom Fiore noted that on page 16 of the BBH presentation the greatest excess return was within the auction cycle trading and asked if other mangers do the same thing. Mr. Baker said that he believes other firms exploit this relationship and elaborated on the strategy used by BBH.

Sharon Palmer challenged BBH on their diversity noting that there are no senior managers who are Black or Hispanic and that only 1% of the investment professionals are Black and 1% Hispanic and those percentages are both male and female. Mr. Schoenfeld said they work at the diversity issue on an ongoing basis and pointed out that over the last five and ten years percentages continue to increase both for minorities and women in the investment management business and at officer levels. He said that the BBH affirmative action program is very well structured and two years ago BBH was designated as an affirmative action contractor by the U.S. Government, which puts in place a set of protocols and goals to meet over several years. He indicated that BBH is not where they want to be, but is advancing their demographic diversity and striving for improvement. Mr. Parker asked how many of the 39 partners are minorities and how did BBH describes minority. Mr. Schoenfeld said two partners are minorities. Mr. Parker asked how many are African-American. Mr. Schoenfeld's response was that none are African-American. Mr. Parker asked how many are women to which Mr. Schoenfeld replied that two are women. Mr. Parker indicated that normally women are not considered minority. Mr. Schoenfeld said that of the 39 partners, two are Asian and two are women. Mr. Parker further commented that while BBH has been in business for a very long time, they have made very little progress in the area of affirmative action and said that what he would like to see is a commitment by BBH to be at a certain point in affirmative action efforts within a given period of time. Mr. Schoenfeld pointed out that in his first meeting with the Treasurer, she spoke about the same issue and brought up the Inroads program, which is currently being evaluated by BBH in terms of expanding their diversity activities and affirmative action activities. Mr. Parker said again that if BBH has been in business since 1818 they should have made a little more progress than some of the firms that have only been in business 18 years and commented that a company can't be the oldest firm and be among those with the worst performance in affirmative action.

Settlements (not on the agenda)

Chairman Roberts announced that he had just been handed a letter dated December 9 from Triumph Capital addressed to the Connecticut State Pension and Retirement Fund, attention of Ms. LaMarr. He read the letter from Frederick McCarthy, which indicated that as a result of the plea agreement entered into on September 3 with the United States Attorney's Office for the District of Connecticut, there was a check enclosed in the amount of $850 thousand as restitution to Connecticut State Pension and Retirement Trust Funds. Chairman Roberts said that Madame Treasurer deserves a lot of credit. There was a round of applause by all present at the meeting.

Ms. LaMarr informed the IAC that on November 7, she and Gary Draghi, Principal Investment Officer, participated in settlement negotiations with the law firm that represented Keystone in connection with a settlement agreement with Michael Liberty, an individual who stole money from Keystone V. She said that the settlement agreement was for $4.8 million and CRPTF's portion is a little more than $1 million.

Presentation by Hartford Investment Management

Hartford Investment Management ("HIMCO" or "The Hartford") made a presentation to the IAC regarding its inflation protected securities. HIMCO was represented by David Znamierowski, President; Ronan Burke, Senior Vice President and Director of Institutional Sales; and Bill Davison, Managing Director and Director of Funds Management. Their presentation included an overview of HIMCO, the firm's investment philosophy, investment process, investment strategy, performance history and community activities.

Cynthia Steer of CRA RogersCasey asked HIMCO to comment on the questionnaire and the latest on the mutual fund issues. Mr. Znamierowski said that HIMCO has had mutual funds under their variable annuity program and regular retail mutual funds for about two decades and through the life of those funds has aggressively discouraged market timing. He said that in light of the issues over the past few months, HIMCO has conducted a comprehensive review of its fiduciary responsibilities with regard to trading practices. Mr. Znamierowski said that HIMCO has asked for input not only from within their organization but also from all the sub advisors and has found no wrongdoing. He also indicated that in terms of late trading there are about 11 million trades processed each year and trading records have been reviewed and there is no evidence of trades being allowed to settle after 4:00 p.m. HIMCO has carefully reviewed and is very familiar with all the issues surrounding market timing and has dedicated an annual budget of about $500 thousand for the staff and technology to detect and eradicate market timing behavior within their funds and that this has been ongoing for years.

Mr. Parker asked if it would be fair to say that with respect to corporate social responsibility and cultural diversity, HIMCO has not done much of anything in that area. Mr. Znamierowski said the he does not think that is a fair characterization and that the efforts at HIMCO to improve diversity have been significant but that the results of those efforts have not put HIMCO where they would like to be. Mr. Parker pointed out that the State of Connecticut retirees are a culturally diverse group and asked if HIMCO was selected would the firm make a commitment over the next two years to diversify more. He then asked how many women are in senior management, to which Mr. Znamierowski replied that one of the six senior managers is female. Mr. Parker then asked about African-Americans and Hispanics within the same group. Mr. Burke spoke about the minority MBA program in which the Hartford is involved; students are funded and placed throughout the organization. He said that this is a first step to address the issue of diversity. Mr. Znamierowski said he would be more than willing and happy to come back in one year and report on what progress has been made in that time to improve and promote diversity within the organization. Mr. Parker said what he wants is for HIMCO to advise where they are currently, where they expect to be in one year and then to report on how successful they have been in achieving their goal. Mr. Znamierowski said that it would be very difficult to anticipate the management of human capital in their organization because they are a growing and changing organization. He also said that he and his staff are committed to cultural diversity and willing to be held accountable for showing progress.

Ms. Thomas referenced the book from RogersCasey on page 22 relative to percentages on diversity and HIMCO and questioned how HIMCO came up with the percentages in the book because the figures did not seem accurate. Mr. Burke said that it was clearly a mistake.

Ms. Palmer expressed interest in the STAG program that HIMCO has with the Hartford schools and asked them to elaborate on the program. Mr. Znamierowski said the STAG program began in 1966 and there have been 1,600 juniors and seniors that have participated in the program. He further explained that it is a program providing the opportunity for juniors and seniors to work full time in the summer and part time during the school year.

Presentation by Standish Mellon Asset Management

Standish Mellon Asset Management ("Standish Mellon") made a presentation to the IAC regarding its TIPS product. Standish Mellon was represented by Thomas Sorbo, Chief Operating Officer; Marc Seidner, Director of Active Core Strategies; and Robin Buhrer, Senior Relationship Manager. Their presentation included an overview of Standish Mellon, the firm's investment philosophy, investment process, client service, community leadership and commitment to diversity.

Mr. Parker asked what kind of commitment Standish Mellon makes to the organizations shown on page 6 of their presentation. Mr. Sorbo responded that besides a monetary commitment, staff also gives time to projects. Mr. Parker then asked if the senior management staff was an integrated staff. Mr. Sorbo said that there are seven individuals on the executive committee and two are women. Mr. Parker asked if there were any African-Americans on the executive committee and the response from Mr. Sorbo was negative. Mr. Parker asked if Standish Mellon uses minority firms for trading. Mr. Sorbo explained that the firm trades on the best execution basis for their clients, and they access over 35 brokers of which several are minority owned brokerage firms and Standish Mellon chooses the best price of those brokers for the client. Mr. Parker persisted in his effort to determine how many of the brokers with whom Standish Mellon trades are minority owned, how many are women owned and how much business goes to those firms. Mr. Sorbo said he would be pleased to get that information but does not have it with him.

Ms. Thomas said that information from RogersCasey indicated that the weighted average duration is ten years and with the potential for a rise in interest rates, she wanted Standish Mellon to address that issue. Mr. Seidner said the average duration is currently about nine and a half years and explained how duration expresses the price sensitivity of a bond. He also said that, due to the correlation between changes in real interest rates and changes in nominal interest rates, the actual interest rate sensitivity of an inflation protected securities portfolio is about 50 to 75% of a comparable Treasury portfolio. Consequently, the nine and a half year duration is a calculated cash flow duration, which probably equates to a price sensitivity of about five to seven years. The other point Mr. Seidner made is that, given the current TIPS landscape, a valid strategy is to focus on an intermediate and shorter benchmark. He also added that about 70% of the TIPS universe is comprised of bonds that mature between one and ten years.

<u>Roll Call of Reactions for Finalists for Inflation Linked Bond Managers</u>

Ms. Schoonmaker said she was most impressed with The Hartford and second with Brown Brothers and that she especially liked The Hartford because they are a local firm. Ms. Barnett said her first choice was Standish Mellon and that their client list was quite impressive on all aspects. She asked RogersCasey why it was significant that The Hartford's investment professionals do not have ownership in the firm. Ms. Steer said that generally an asset management firm's pay is linked to their performance, and ownership creates strong performance incentives. Ms. Barnett also commented on BBH's lack of diversity and said that she did not hear enough of the presentation by The Hartford to make a decision about them. Ms. Thomas said these firms are very close together but tends to go with Brown Brothers based on consistency of results and second with Standish Mellon based on general impressions and their conservative approach. Mr. Roth commented that Standish Mellon fees were considerably lower than the other firms' fees and asked Ms. Steer if she could explain that. Ms. Steer said that it is because their approach is considered to be quasi-passive. Mr. Roth said he was favorably impressed with Brown Brothers, but not thrilled with their social profile. Mr. Roth said he liked The Hartford for several reasons; in his opinion they have a more realistic view because they have a wider range and he has a bias toward The Hartford because they are a local company and employ people in this city and this state; and their charitable giving is more directed to this city and state. Mr. Parker said any of the three firms could manage the money with no problem, but that he is more concerned with their social responsibility. He said that what he feels really counts is the diversity of the firms with whom they are trading and what he wants to see is what they plan to do going forward toward that end. Mr. Parker chose Brown Brothers first and said the other two firms, in his opinion, were equal. He made one last point of saying that there should be a "little" advantage to a local firm. Mr. Fiore chose Brown Brothers and agreed with Mr. Parker that the other two firms were close together. Mr. Fiore said he was impressed by Brown Brothers' long track record and that their excellent performance makes a strong case for them. He also agrees that, everything else being equal, the local firm should be given somewhat of an advantage. Mr. Fiore also noted that according to the book from RogersCasey, Brown Brothers has the best statistics on diversity. Ms. Palmer chose Brown Brothers, The Hartford, and then Standish Mellon. She does feel that we need to continue to discuss the diversity issue and that these companies really need to bring a different look. Chairman Roberts chose Brown Brothers first, The Hartford second and Standish Mellon third.

Mr. Parker asked if when the Treasurer selects the firm with whom the Treasury will do business, would that firm be told that the Treasury feels that they can handle the money but that they need to upgrade their social responsibility in the future and that the Treasury will be watching that. Treasurer Nappier indicated that this issue has come up repeatedly with both financial and non-financial vendors and the Treasury does not have a compliance unit to track this issue. It is the same with brokerage firms, we do not direct trades to any particular firm, but we do have a general policy that says the managers should look to do business with local Connecticut firms, minority owned firms, women owned firms and emerging firms.

Ms. Barnett said she wanted to amend her comments on The Hartford because even though she had not been present for most of their presentation, she had read their materials and is sensitive to the fact that they are a local company. She feels that The Hartford may position CRPTF better for the future because of their eclectic approach to the market.

A motion was made by Ms. Schoonmaker, seconded by Mr. Parker, to waive the IAC 45 day comment period. The motion was passed unanimously.

<u>Presentation by, and Consideration of Recommendation to Invest in, KPS Special Situations Fund</u> and
<u>Presentation by, and Consideration of Recommendation to Invest in, FS Equity Partners V</u>

David Scopelliti, Principal Investment Officer, said the first presentation would be by KPS Special Situations, which is a turnaround and restructuring fund with a rather unique deal flow and focus in that they work in partnership with many unions across the country. He said the second presentation would be by Freeman Spogli, which is a middle market buyout fund focused on the consumer, retail and distribution sectors of the economy.

Presentation by KPS Special Situations Fund

KPS Special Situations Fund II, L.P. ("KPS") made a presentation to the IAC regarding its private equity limited partnership that focuses on investing in restructurings, turnarounds, and other special situations. KPS was represented by Eugene Keilin, Principal; Michael Psaros, Principal; David Shapiro, Principal; and Raquel Palmer, Principal. Their presentation included an overview of KPS, the firm's investment strategy and a sample of their rewards and risks.

Mr. Roth asked how KPS sources their management teams for portfolio companies. Mr. Keilin said that their approach is to identify qualified individuals, and frequently to work with them in the process of putting the transaction together, so the KPS knows the management team's capabilities before making an investment.

Mr. Fiore asked first why Connecticut should invest in a firm that (i) invests so much in manufacturing when there are so many manufacturers moving out of this country and (ii) must endure a complicated and frustrating transaction process. Mr. Psaros pointed out the success of the investments that KPS has made. He said that KPS has carefully and purposefully invested in manufacturers that produce very high value added goods that rely on intellectual property. He then used some of the investments in the KPS I and II to make his point. Mr. Psaros added that KPS purposely avoid commoditized businesses because the commodity businesses are going to flow to other countries. In response to the second question, Mr. Psaros said that the typical process is that KPS will receive a call from a union and KPS will be invited in to determine how to "fix" a company. He said that in some cases there are massive legacy liabilities, such as unfunded defined pension liabilities, retiree health liabilities and excess capacity. Mr. Psaros said that the important point for KPS is that they do not go into a company and implement any restructuring, unless the bargaining unit has affirmed that it would like to proceed with KPS and the stated restructuring plan. Mr. Keilin added that the approach of KPS is constructive investing. He said that KPS does not do a deal unless all involved (employees, customers, creditors, suppliers) want them to do the deal and understand the terms.

Ms. Barnett noted that KPS does not assume legacy liabilities and asked if anyone does. Mr. Psaros said that KPS has companies with defined benefit pension plans, multi employer Taft Hartley pension plans and that all active employees at all of their companies have very good health care plans. In summary, Mr. Psaros stated that when there is a bankruptcy, as part of that bankruptcy there may be a huge unfunded pension liability or an unfunded retiree health care liability, a problem not created by KPS. He said KPS will ensure that the employees of the new company will have a pension and health care, but KPS does not assume the unfunded liabilities of the predecessor entity. He also said that there are no financial sponsors that will assume those liabilities.

Sharon Palmer asked about the diversity of the firm. Raquel Palmer responded that she is Hispanic, a woman and one of five partners with the firm and that the chief financial officer is a woman and the treasurer is also woman and a minority. Mr. Keilin said that is frequently the case in the portfolio companies in which they invest.

Mr. Parker asked if those who invest in the program are on any advisory committees with whom KPS works. Mr. Keilin said that KPS does have an advisory board, which is common in private equity funds, but that not every investor is a member of that advisory board. He said there is a very diverse and representative advisory board. Mr. Parker asked if KPS selects members, or recommends members or if they are selected by others. Mr. Keilin said they are selected by KPS with the consensus of others involved.

Presentation by FS Equity Partners V, L.P.

Freeman Spogli & Co. ("FS") made a presentation to the IAC regarding its Private Equity Fund V that focuses on making buyout investments in middle-market companies in the retailing, direct marketing, catalog and distribution industries. FS was represented by Ronald Spogli, Principal; John Roth, Principal; and William Wardlaw, Principal. Their presentation included an overview of FS, the firm's investment criteria, their target markets and corporate citizenship.

Mr. Wardlaw spent some time explaining the role that good corporate citizenship plays with FS. He said FS contributes to a number of local charitable institutions and schools and to a number of universities and colleges throughout the country. He said that several of the FS partners have founded scholarships at universities including at Stamford and Notre Dame dedicated to minority students. He explained that they have also encouraged their portfolio companies to be good corporate citizens, for example one of the portfolio companies is one of the largest corporate players in Habitat for Humanity, building over 350 homes primarily in the southeastern part of the United States. Mr. Wardlaw went on to explain the investment philosophy that focuses on growth and that as a result of that philosophy over the last ten years 40% of the money FS has invested has been into their existing companies so that they could grow. He said that currently their portfolio companies employ approximately 100,000 people in the United States, approximately 1,000 in Connecticut. He said they help union companies to remain union companies, they will make no investment that would lead to the privatization of public sector jobs and because of this emphasis on growth it is their philosophy to attract investors such as public employees and teachers of California, Ohio and New York, as well as Taft Hartleys. Mr. Wardlaw said that FS believes there have been very few firms that have been as successful as they have been in investing in the urban market. He said that a grocery store chain in which they invested in 1985, located primarily in the African-American and Latino sections of Los Angeles, was one of the most successful early transactions done in their business that focused on the urban core. He also said that since that time FS has made a number of transactions that service those communities.

Mr. Roth asked from where their deal flows generally originate and are they generally proprietary deals or does FS bid. Mr. Spogli said that FS markets themselves as specialists in the consumer distribution area and because of that FS has been able to generate about 2/3 of their deal flow from non-auction sources.

Private Investment Fund Review as of June 30, 2003

Mary Kelley of INVESCO Private Capital gave an executive report on the status of CRPTF's Private Equity Fund as of June 30, 2003. She said the internal rate of return has improved by 54 basis points over March 30 and that is a reflection of improving market conditions. She pointed out that, in general, the public markets are benefiting the private markets and the individual changes in quarterly returns within this portfolio show more positives than negatives and those with significant changes of 3% or more are primarily due to those funds that hold portfolio companies that are public in nature. Ms. Kelley also gave an update on Triumph and said that the Camelot Group has begun to market CRPTF's interests in those funds and INVESCO has been very active on the advisory committee for Triumph Capital III.

Mr. Roth asked if CRPTF has a definite plan for investing in private equity, for instance, what percentage of private equity portfolio does CRPTF plan to be invested in venture, buyout or turnaround. He wants to know if there has been an exercise in putting together a plan toward that. Mr. Scopelliti said that there is an ongoing evaluation and development of a longer-term plan. Ms. Kelley said INVESCO has reviewed about 400 funds this year, all of which are reviewed with criteria in mind for what might fit the CRPTF portfolio. She said INVESCO looks at the IPS as to gross allocation and then within that looks at the industry concentration within the current portfolio and when the Treasurer's office authorizes a due diligence, INVESCO prepares a two page memorandum that reviews exactly how a fund will fit into the portfolio. Mr. Roth then asked if there is an overall strategic written plan that has been shared or that can be shared with the IAC. Chairman Roberts said it is the IPS. Mr. Scopelliti said staff is reviewing the current IPS. Mr. Roth expressed concern over ending up in the position a year from now of having piecemeal funds that end up as a portfolio that does not fit the profile that is planned. He said he would like to see a plan that clearly states the percentages of different types of funds that would make up the portfolio. Ms. Sweeney said that Mr. Scopelliti has initiated a plan to analyze the current composition of the private equity portfolio of the CRPTF. She said there have been meetings with INVESCO, State Street Bank and their private equity tracking group and the Treasury's internal staff. The Treasury is also looking at the fund-of-funds exposure to determine what is venture, what is buyout, etc. Pension Funds Management is in the process of adding some resources, trying to build some staff and one of the first projects planned is a strategic plan to complete what is already started. Mr. Scopelliti added that based on preliminary figures, calendar year 2003 could produce strong positive cash flow for the Private Investment Fund.

Discussion of Private Equity Presentations

There was a discussion regarding the investment opportunity in the two private equity funds. Treasurer Nappier explained how she determined the range of the amount of money recommended for investment. She said that both firms were screened by INVESCO and that Ms. Sweeney and Mr. Scopelliti were very involved with the due diligence. There was an extensive discussion relative to placement agents, third party disclosures, finders and finders' fees. One of the placement agents for FS employs Peter Borges who is related to the former Connecticut State Treasurer. Deputy Treasurer Rifkin explained that it is illegal, by statute in Connecticut, to pay finders' fees but that there are exceptions that include an individual who is a licensed registered securities dealer and is in engaged in the business of putting together willing investors and funds. Ms. LaMarr said the definition of investment professional is an individual or firms whose primary business is bringing together institutional funds and investment opportunities, who is a broker dealer, licensed under Connecticut, registered with the SEC or with the NASD, is licensed under one of the sections of Connecticut as a real estate broker or furnishes investment management services. Mr. Roth asked if there is any reason to believe that any of the three placement agents that are involved with these two firms do not fall within the exceptions allowed by the statute. Treasurer Nappier said absolutely not but that as part of the process there will be a final review conducted before the contract is executed and if there is any question about the legitimacy of these firms to serve as third party agents then it will be given to the Ethics Commission for a ruling. Deputy Treasurer Rifkin said that the firms would have to provide an affidavit to the effect that they have made third party payments and that third party payments meet the exception to the ban on finders' fees in Connecticut.

Ms. Thomas made a motion, Ms. Schoonmaker seconded, that the Treasurer be authorized to invest $20 to $40 million in KPS Special Situations Fund and that the IAC waive the 45-day comment period. The motion was passed unanimously.

Ms. Schoonmaker made a motion, Ms. Thomas seconded, that the Treasurer be authorized to invest $50 to $75 million in FS Equity Fund V and that the IAC waive the 45-day comment period. The motion was passed unanimously.

Mr. Fiore addressed the issue of the IAC's 45-day comment period and said that it seems to him that the 45-day comment period is always waived. Treasurer Nappier explained that it is the prerogative of the IAC to waive or not and that prior to the 45-day rule the Treasurer had no obligation to come before the IAC. She said that the 45-day rule was crafted to allow the IAC the opportunity to review an issue and not have to make an immediate decision. With private equity, time is crucial. Ms. Sweeney pointed out that the more time there is, the earlier a commitment can be made, and the more influence the Treasury has in the negotiation of the documents. Treasurer Nappier added that, as part of the internal process, the IAC has been given the opportunity to be involved before the recommendation is made. She said that IAC members may participate in interviews at the staff level and can help decide which firms will come before them at the Council meeting to present. Mr. Fiore said that he does appreciate that, but private equity is the asset class that caused so much trouble and all the reforms that took place were an outgrowth of those problems and he said he would think that the 45-day grace period would be part and parcel of that reform. He said that it concerns him that the waiving of the 45-day comment period may become standard operating procedure. Treasurer Nappier said that the intent was to ensure that the IAC has an opportunity to review a proposal and if the IAC does not act in 45 days, she is then free to execute the contract. Chairman Roberts and Ms. Sweeney pointed out several instances where the 45-day period was not waived.

Strategic Review and Investment Plan for Real Estate

Mr. Draghi introduced Marc Weiss of Pension Consulting Alliance ("PCA") who presented a strategic review and investment pacing plan for real estate. PCA's presentation included strategic review findings, an outline of the objectives for the program, a summary of the key elements of the pacing plan and the next steps.

Mr. Roth asked what the correlation of REITs is to the overall public stock market as opposed to a real estate asset allocation. He also asked if PCA considered whether CRPTF managers, especially mid cap managers, may have a fairly large amount of REITs in their portfolio so that there is more exposure to REITs than they may think. Mr. Weiss said that if one reviews REITs over time their performance displays low correlation to the broader indices. Mr. Weiss said that the way PCA views REITs is that there are two ways to invest in the context of a real estate allocation. First, he said from a tactical standpoint, once investments are made in private equity real estate, REITs can be used to round out any gaps in the portfolio. Second, the REITs market can be used more opportunistically in tandem with other investments in the real estate allocation, as there are times to be in the REITs market and times not to be. Mr. Weiss said that in the proposed pacing plan PCA does not recommend entertaining an allocation to REITs for at least another year or two. He said that with regard to REITs and whether they stand with mid cap or small cap strategies, historically REITs comprise up to 10% of the Russell 2000 Index and some are included in the S&P 500 Index. He said it is the view of PCA that managers who are investing in REITs are probably doing so for other than real estate reasons. Mr. Roth asked what PCA's advice would be on how to access the REIT market. Mr. Weiss said they would recommend going through a manager that would specialize in real estate securities. Ms. Sweeney commented that there has been a lot of talk about liquidity in the portfolio and issues surrounding that the current real estate pacing plan based on a number of assumptions. She said that this plan will be reassessed frequently as the Treasury continues to review what the rest of the portfolio looks like and receives new actuarial studies that provide an updated picture of liabilities.

Real Estate Fund Review as of June 30, 2003

Mr. Weiss said that PCA does not have the complete quarterly performance report available but will be prepared to give a complete report at the next IAC meeting. He added that he did, however, have a brief flash report to summarize the performance for the quarter ending June 30. He said the fund generated a return of 1.5% and 1.2% net of fees and that the NCREIF property index, the benchmark that is used, posted a 2.1% return for the quarter. Mr. Weiss said that over the longer term, there is a return posted of 4.7% for three-year and 7.7% for five-year while the NCREIF property index posted 8.2% and 9.8% for this same time period. He also said that looking at the portfolio as a whole, there were no new commitments during the period and that $3.8 million was funded toward satisfying existing outstanding commitments. He said the portfolio remains heavily tilted toward non-traditional sectors and lower cash flow investments but that these will be corrected over time as the pacing plan is implemented.

Treasurer Nappier explained that the real estate guidelines were accepted by the IAC and that the real estate guidelines along with the due diligence process is a complete, comprehensive document regarding how the Treasury is going to conduct business within the real estate market. She recommended that, if not today, then next month the IAC accept the due diligence procedures. Chairman Roberts said that there is no longer a quorum present to vote so this should go on the agenda for next month. Treasurer Nappier also commented that it is the

Treasury's intent to actively begin investing in real estate and one thing she would like to do is consider the current managers for new investments and she expects that during the next year the process of interviewing prospective managers will begin. She noted that the Treasury has reached an agreement with PCA recognizing that there needs to be a separate core account but that a commingled account can also be used. It is her intention that both will be moved simultaneously.

Commercial Mortgage Fund Review as of September 30, 2003

Mr. Draghi reported on the Commercial Mortgage Fund indicating that the value of the Fund as of September 30 was $49.9 million. He said that distributions had taken place during the quarter of approximately $23 million, the result of a prior loan payoff that proved to be lucrative to the Treasury. He said the money has now been distributed to the unit holders. Mr. Draghi said that with regard to diversification, residential exposure dominates the property type asset allocation and the geographic diversification is impaired by the fact that a number of regions are now missing from the portfolio mix. Mr. Draghi informed the IAC that the Fund outperformed its benchmark by 128 basis points for the quarter. He said that the trailing ten-year performance numbers exceeded the benchmark by almost 200 basis points. He said the goal of the Fund is to exceed its benchmark by 100 basis points and that the Fund has succeeded in that regard.

Combined Investment Funds Review as of September 30, 2003

Raudline Etienne of CRA RogersCasey reported on the overall investment results for the CRPTF as of September 30, 2003. She said that during the third quarter there was increased optimism on a global basis relative to economic recovery and the global equity markets continue to rally. The S&P posted a 2.6% return and the broad U.S. equity market inclusive of small cap was up 3.4%. CRPTF gained 3% in the third quarter, which was an underperformance of 50 basis points to the target allocation benchmark, and that is primarily because of deviations from the asset allocation policy. She said there was overweight to fixed income and in this quarter fixed income was a negative and was therefore detrimental relative to the long-term policy. Ms. Etienne noted that this was the first quarter that the private equity benchmark used was Venture Economics Index. Ms. Etienne indicated that both the Mutual Equity and Mutual Fixed Income Funds posted gains relative to their proxies. She said that in the International Stock Fund, CRPTF was not fully invested as of September 30 and that process, given the rally in the international market, made any cash a drag on results. Ms. Etienne noted that the Securities Lending Income was $1.5 million for the quarter.

Short-Term Investment Fund Review as of September 30, 2003

Harold Johnson, Principal Investment Officer, reported on the performance of the Short Term Investment Fund ("STIF") for the quarter ending September 30, 2003. He said that for the months of October and November, STIF earned an effective yield of 1.16% and 1.19% respectively versus 0.74% and 0.75% for the benchmark.

Report on Corporate Governance and MacBride Compliance

Meredith Miller, Assistant Treasurer-Policy, gave a report on Corporate Governance and MacBride compliance for the quarter ending September 30, 2003. She reported that on domestic proxies, votes against management were 56.2%, which is about 10% lower than it has been in the past and for global voting activities, votes against management were 8.1%. Ms. Miller noted that the international proxy voting by outside investment managers was in compliance with the CRPTF's global proxy voting guidelines. She said that both domestic and international proxies are on the web site.

Ms. Miller then spoke about the Institutional Investor Summit on Climate Risk at the United Nations that Treasurer Nappier co-chaired with former Senator Timothy Wirth who is currently the President of the United Nations Foundation. She said that the focus was on a discussion and dialog of investors from the public sector, the labor union sector, foundations and Wall Street about the portfolio risks and liabilities for companies that may be affected by climate risk. Treasurer Nappier commented that this was an historical summit because it was the first time that institutional investors, Wall Street money managers, and investment consultants came together to review climate change as a risk factor and what investors need to do to ensure that the companies in which funds are invested are doing what is necessary to assess risk associated with climate change. Mr. Roth commented that it appears from the report that the general focus of the Office of the Treasurer is on investor and financial risk and then asked if the Treasury is endorsing either scientific or political solutions. Treasurer Nappier responded that the reason for the Treasury's involvement was to examine climate change and its impact on CRPTF's investment portfolio. Ms. Miller said that an outcome of the conference is the creation of an Investor Network on Climate Risk, which will be organized by the same organization that helped organize the summit. Treasurer Nappier also indicated that the she might host an institutional investor summit on climate risk in Connecticut.

Ms. Miller then gave an update on the Treasurer's involvement with governance reform at the New York Stock Exchange ("NYSE"). She said that John Reed, Acting NYSE Chairman, has proposed and that the NYSE members approved new governance structure for the NYSE, which is pending SEC approval. Ms. Miller reminded the IAC that when Treasurer Nappier met with Acting NYSE Chairman John Reed, she encouraged the NYSE to have an outside body review and recommend necessary reforms for its organization as well as other exchanges and to split the operation and regulatory functions of the exchange, which is now combined. She reiterated these concerns and also spoke about her support for shareholder access to proxy, when she subsequently met with the Chairman of the SEC, William Donaldson.

Ms. Miller reported that for the proxy 2004 season, Pam Bartol, Assistant Investment Officer, is in the process of continuing to complete the filing of shareholder resolutions on behalf of the CRPTF and therefore the list of seven companies in the report at which resolutions have been filed is not complete.

Ms. Miller reported that the Treasury is in full compliance with MacBride.

Other Business

Review of the IAC budget for the quarter ending September 30, 2003

Chairman Roberts reported that the IAC is operating under budget.

Pension Funds Management Division's operating results as of September 30, 2003

Ms. Sweeney reported that the operating results include the combined investment funds and investment activity by pension plan for the quarter ending September 30.

Status Report on Requests by IAC Members

Ms. Sweeney said that the report that IAC Members received in a separate mailing was a response to an issue raised in the February meeting regarding the underlying plans and the impact of the payouts versus the contributions. She said that Greg Franklin, Assistant Treasurer-Investments did this analysis and prepared the cover letter for the IAC, and added that the report is very thorough and well done. Chairman Roberts commented that it is an excellent report and he feels that this is an issue that needs to be watched, particularly if there is going to be a new actuarial study completed sometime in the near future. Mr. Franklin said that this report evolved out of the financial report that was distributed to the IAC quarterly, but that the IAC members found difficult to determine what the contributions and disbursements were and that initiated the current report. This report shows the activity that occurs within PFM, and at the State level. The report shows the actual State contributions and actual employee contributions, most of which gets disbursed for benefit payments and does not get invested. The contributions are being paid out as they come in. Mr. Franklin also noted that the State Employees' Retirement Fund is in the process of analyzing the recent early retirement program initiated at the end of last fiscal year and expected a re-certification of what the contributions should be given the retirement activity. Mr. Fiore asked if the expectation was to operate in this net negative position for many years to come. Treasurer Nappier responded that is the case and added that the purpose of the investment fund is to help finance the State's obligation. Ms. Sweeney pointed out that the uniqueness of this report is that it is an unusually big picture view and Mr. Franklin had to gather information from Cash Management, the actuaries, and the Comptroller's Office to bring all the pieces together and at the Treasurer's request will be reporting on this quarterly. Treasurer Nappier informed the IAC that the Office of the Treasurer does not control the expenses of the pension system with the exception of the Treasury staff, nor does it control benefit payments, withdrawals, or early retirement incentive plans, which all draw funds from the CRPTF and change continuously.

Discussion of preliminary agenda for January 14, 2004 IAC meeting

Ms. Sweeney said that at the January meeting there will be an update on domestic equity brokerage program, five emerging market debt managers making presentations and the acceptance of the real estate due diligence process.

Ms. Etienne reported that Timothy Barron, head of CRA RogersCasey research, has offered to make a presentation to the IAC on the manager rankings in January or February. Chairman Roberts said that February would be better.

Ms. Sweeney announced that the Treasury has been awarded a Certificate of Excellence in Financial Reporting by the Government Finance Officers Association. She said that this is an honor attributable to the extensive work that goes into the annual report, its accuracy and timeliness and that the recognition is well earned.
Treasurer Nappier said that she wanted to make a retraction relative to the discussion about workforce diversity and the firms that came before the IAC and their commitment to workforce diversity and the Treasury's ability to monitor that area. She said there has been some progress in putting together a system to do that and asked Guy Garcia, Principal Investment Officer, to brief the IAC. Mr. Garcia said that the Treasury requires all managers to submit a workforce composition every year and will plan to monitor that on an annual basis. Treasurer Nappier said that she and Mr. Garcia worked extensively on the reporting form that managers will be asked to complete. She pointed out that there are sometimes circumstances that could keep a company from attaining workforce diversity and in those cases a company would be able to show their commitment to diversity in other ways, such as Inroads for example.

There being no further business, the meeting was adjourned at 4:25 P.M.

Respectfully submitted,

DENISE L. NAPPIER
SECRETARY