

**INVESTMENT ADVISORY COUNCIL  
WEDNESDAY, OCTOBER 12, 2005**

**MEETING NO. 330**

**Members present:**

John Bacewicz, representing  
Robert L. Genuario  
Michael Freeman  
David (Duke) Himmelreich  
James Larkin  
Reginald Martin  
Denise L. Nappier, Treasurer  
Sharon Palmer  
Clarence (Dick) L. Roberts, Jr., Chairman  
David Roth  
Carol Thomas  
Peter Thor

**Absent:**

William Murray

**Others present:**

Howard G. Rifkin, Deputy Treasurer  
Susan B. Sweeney, Chief Investment Officer  
Robyn Belek, Deputy Director of Communication  
Patricia DeMaras, Associate Counsel  
Gary Draghi, Principal Investment Officer  
Greg Franklin, Assistant Treasurer-Investments  
Bernard Kavaler, Director of Communication  
Catherine E. LaMarr, General Counsel  
Shelagh McClure, Director of Compliance  
Meredith Miller, Assistant Treasurer-Policy  
Judy Balich, Executive Secretary  
Sarah Carter, Administrative Assistant

**Guests:**

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

Chairman Dick Roberts called the meeting to order at 9:15 A.M.

### Approval of Minutes

Chairman Roberts asked for comments on the Minutes of the September 14, 2005 Investment Advisory Council (“IAC”) Meeting. There being no comments, **a motion was made by Peter Thor, seconded by Carol Thomas, that the Minutes of the September 14, 2005 IAC meeting be accepted as drafted. The motion was passed unanimously.**

### Opening Comments by the Treasurer

Treasurer Denise Nappier said that she had just returned from the Annual Convention of the National Council on Teachers’ Retirement where she had been a guest speaker. She noted that one of the highlights of the convention was that Clare Barnett, who resigned from the IAC last year after 18 years of service, was overwhelmingly elected president of the Teachers’ national organization.

Treasurer Nappier noted that at today’s meeting, there would be presentations from the three managers that are on the Connecticut Retirement Plans and Trust Fund (“CRPTF”) Watch List. She said that unlike the retention of money managers where a Connecticut State Statute prescribes a specific role for the IAC [Section 3-13b (c) (2)], the Investment Policy Statement provides guidelines (Part I, Article XI<sup>1</sup>) for the conditions under which a manager would be placed on the Watch List. Treasurer Nappier said that these managers have been on the Watch List for quite some time and that several months ago she elected to continue to keep them on the Watch List and bring them before the IAC so that the IAC would have an opportunity to express opinions on the future of the managers. She indicated that it is her intention, subsequent to today’s meeting, to consult with staff and the consultant and make a determination either to continue the manager on the Watch List or to terminate.

Treasurer Nappier elaborated on the information in the Corporate Governance and MacBride Compliance report regarding the Insurance Industry Summit on Climate Risks and Opportunities. She said that this summit is jointly sponsored by the Office of the Treasurer (“OTT”), Connecticut Insurance Department and the Department of Environmental Protection. Treasurer

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<sup>1</sup> Periodically, it may be necessary, in the best interests of the CRPTF, to place a Manager on a “Watch List.” The following conditions can trigger placement on the Watch List:

- The manager significantly under-performs its benchmark for three consecutive quarters;
- The manager experiences turnover of key members of the investment professional staff;
- The CRPTF becomes aware of a significant event affecting the manager such as (but not limited to) change of control; a large quarterly loss; the disclosure of SEC or other federal investigations or inquiries into the manager’s operations; or
- Any other event that could affect the manager’s ability to perform its investment management responsibilities for the CRPTF.

Once an investment manager is placed on the Watch List, the situation triggering such placement will be reviewed by the Treasurer and/or the Chief Investment Officer. This review will entail a comprehensive analysis of the situation, through various means, such as site visits, conference calls, assessment of the likely impact of the situation, etc. If such analysis does not alleviate the concerns of the Treasurer, a decision will be made whether to (a) continue to monitor performance, or (b) terminate the manager.

Nappier noted that Connecticut has been one of the leading states on energy and climate change and that the Connecticut insurance industry and the State of Connecticut have come together to collaborate on these issues. She said that the Governor is involved and sent the first notice regarding the summit to the insurance companies. Treasurer Nappier said that the summit is scheduled for October 27, 2005 and that she is expecting a fairly good turnout. Meredith Miller, Assistant Treasurer-Policy, said that she has a letter and an agenda that she will give to the IAC members when she reports on Corporate Governance and MacBride Compliance.

Treasurer Nappier provided the IAC with the outcome of the presentations made at the September IAC Meeting. She reported that after considering the IAC comments and receiving the waiver of the 45-day comment period, she decided to commit \$20 million to Rockwood Capital for their latest real estate fund. She said that, once again, based on favorable feedback and waiver of the 45-day comment period by the IAC she decided to commit \$100 million to Welsh, Carson, Anderson and Stowe, a private equity manager, who presented their Fund X to the IAC. Treasurer Nappier noted that both commitments are pending satisfactory completion of contract negotiations.

Treasurer Nappier commented that last year the OTT agreed to support the reincorporation to the United States from Australia of one of CRPTF's portfolio holdings, News Corporation. She said that one of the things considered in giving that support was that News Corporation would put before the shareholders for a vote any new poison pill after their current poison pill expired. She said that News Corporation did not do that, but did adopt new language. Treasurer Nappier said that the OTT has joined with ten Australian funds, one Dutch fund and two other US funds in an action to require News Corporation to seek shareholder approval of the extension of the poison pill. Mr. Larkin said that he knows the operation and principals and he fully supports the OTT's position.

Treasurer Nappier said that a managing director of American International Group ("AIG") has been indicted for federal corruption, but that his indictment should not have an impact on the management of the portfolios AIG manages for CRPTF. She said that CRPTF would continue to monitor the situation. Catherine LaMarr, General Counsel, said that based on the information from Principal Investment Officer David Scopelliti and the consultant, Franklin Park, this would be a non event for CRPTF. Ms. LaMarr said that no CRPTF funds were involved in the activities that were part of the indictment.

Chairman Roberts said that he would like to invite Reginald Martin to report on the Audit Committee Meeting held this morning. Mr. Martin said that the auditors informed the Audit Committee that they would produce an audit of the funds on schedule, but that the audit of the Treasurer's Office is being delayed again due to problems in the Comptroller's area caused by the implementation of the CORE system. He said that the auditor did indicate that his initial impression was that there were no problems to report with respect to the Retirement Funds or in the Treasurer's Office. Mr. Martin said that each Audit Committee member was required, by a new auditing regulation, to make a statement indicating whether or not he or she has any knowledge of fraud either within the Treasurer's Office or within the Funds. Chairman Roberts noted that it was a clean audit and that Treasurer Nappier and OTT staff were to be congratulated.

### CRPTF Final Performance for August 2005

Susan Sweeney, Chief Investment Officer, reported that for the month of August 2005, the CRPTF returned .4%, which was 22 basis points above the benchmark. She said that total equity exposure is being monitored because it again exceeds the 60% statutory cap, despite a redistribution in May that brought exposure below 60%. Ms. Sweeney said that domestic equities returned -.86% in August, 9 basis points ahead of the Russell 3000 and 5 basis points ahead of the S&P 500. She said that the Mutual Equity Fund's largest manager, Barclays Global Investors, outperformed the S&P500 by 20 basis points in August and for the calendar year to date has exceeded the S&P500 by 162 basis points. Ms. Sweeney reported that the small/mid cap segment of the portfolio outperformed the Russell 2500 by 28 basis points in August. She said that the two managers in that group on the Watch List, TIMCO/Citigroup Asset Management and Brown Capital Management exceeded their benchmarks by 16 and 189 basis points, respectively. She said the International Stock Fund was 71 basis points below its benchmark in August and the Mutual Fixed Income Fund was 4 basis points below its custom benchmark and 11 points above the Lehman Aggregate.

### Quarterly Update on CRPTF Watch List

Ms. Sweeney said that this is the first time that the three managers on the Watch List have been invited to review their portfolios with the IAC.

She said that Morgan Stanley Asset Management Magnum ("Morgan Stanley"), an international core equity product, manages \$330 million for CRPTF, which represents approximately one third of the total assets in this mandate for Morgan Stanley. She said this product has been on the Watch List for some time due to performance and now there is the added element of turnover reaching the highest levels at Morgan Stanley. She said that unless Treasurer Nappier decides to terminate Morgan Stanley, John Mack, the Chairman of the Board and CEO of Morgan Stanley, would be at the December IAC meeting to give an update on the organizational changes.

Ms. Sweeney said that Brown Capital Management ("Brown Capital") would also be at the meeting today and that CRPTF has \$194 million remaining in this account as of the end of August after withdrawing \$177 million earlier in the year due to Treasurer Nappier's decision to reduce CRPTF's exposure to the firm. She said that since that time their performance has improved. Ms. Sweeney said that another concern now is that, because CRPTF was not the only account to withdraw assets from the firm during fiscal year 2005, Brown Capital's total assets decreased from \$5.4 billion to \$2.7 billion. She pointed out that there is continuity on the account with Eddie Brown and Keith Lee.

Ms. Sweeney said that the third firm that would be providing a portfolio update is TIMCO/Citigroup Asset Management ("TIMCO"), downgraded by CRA RogersCasey ("CRARC") and placed on the Watch List by CRPTF when Sandip Bhagat left the firm. She said that when Mr. Bhagat left, several people on the team left with him and TIMCO has had to rebuild a new team. She said that TIMCO has performed poorly and that Citigroup Asset Management announced that it would sell its asset management business to Legg Mason.

**Morgan Stanley Asset Management Magnum Portfolio Review**

Morgan Stanley provided the IAC with a review of the portfolio it manages for the CRPTF. Morgan Stanley was represented by Sandip Bhagat, Francine Bovich and Carter Reynolds, managing directors. Mr. Bhagat provided an update on Morgan Stanley, noting the key priorities of Mr. Mack and reviewed the firm's Global Investor Group. Ms. Reynolds talked about Morgan Stanley's commitment to public funds, noting that CRPTF ranks in the top ten percent of Morgan Stanley's investors. Ms. Bovich provided an account review of International Magnum. Mr. Bhagat summarized their report and talked about ways they plan to improve performance.

James Larkin asked if Morgan Stanley had more or less assets under management than they did one year ago. Ms. Reynolds said that there were more assets now under management. Mr. Larkin commented on detractors in Europe and Japan noted on page 16 of Morgan Stanley's report and asked if Morgan Stanley should take a closer look at their analysts. A discussion followed regarding the European and Japanese markets. Mr. Larkin observed that since Mr. Mack's return to Morgan Stanley, there has been little change.

Duke Himmelreich commented that he feels that Morgan Stanley Magnum performs more as an international value fund rather than a core international fund. There was a lengthy discussion regarding the behavior, performance and history of Morgan Stanley Magnum.

David Roth asked about process in terms of top down allocation decisions; asked what role, for example China and India, would play in that sector; and asked about statistical data on risk management. Mr. Bhagat responded to Mr. Roth's first two questions and Ms. Bovich responded to the statistical data question.

**Roll Call of Comments on Morgan Stanley Asset Management Magnum**

Ms. Thomas asked why CRARC rated Morgan Stanley "not qualified" and Ms. Etienne explained the reason for the rating.

Mr. Larkin said that at this particular juncture he feels that CRPTF would be doing itself a favor by disassociating from the Magnum product. Michael Freeman said that he concurs with Mr. Larkin. Mr. Himmelreich said that he would give Mr. Bhagat the benefit of the doubt due to the positive performance of TIMCO while Mr. Bhagat was with TIMCO and allow Morgan Stanley another year or two to see if Mr. Bhagat could turn the product around. John Bacewicz said that as a new comer, his sense of the presentation was such that he would not rush to terminate but would defer to Treasurer Nappier. Mr. Thor said that he tends to agree with Mr. Himmelreich, although for a shorter period of time. Mr. Martin said that he agrees that CRPTF should disassociate. Sharon Palmer said that she agreed with Mr. Martin. Mr. Roth said that he would tend to disassociate and it would not be his choice to give them more time. Ms. Thomas said that CRPTF should at least reduce their investment and possibly disassociate. Chairman Roberts said that his reaction is that CRPTF should cut its losses and terminate the Morgan Stanley Magnum product.

### **Brown Capital Management Portfolio Review**

Brown Capital provided the IAC with a review of the portfolio it manages for the CRPTF. Brown Capital was represented by Eddie Brown and Keith Lee. Mr. Brown gave introductory remarks on the information they would provide during the meeting. Mr. Lee provided performance information, the firm's small company philosophy including their agnostic behavior regarding benchmarks, recent performance history and the firm's plan of action to improve performance results. Mr. Brown gave an overview of the firm, the firm's history with CRPTF and summarized the report.

Mr. Roth asked what triggers a review of a particular position in the portfolio. Mr. Lee said that any member on the team could challenge any portfolio company at any time for any reason, with some expansion on what a "reason" might be.

Mr. Larkin asked Mr. Brown to explain why their clients withdrew approximately 50% of funds from Brown Capital when the firm, overall, has a pretty good record. Mr. Larkin also commented that although Brown Capital may be agnostic about benchmarks, CRPTF is not. Mr. Brown said that about one third of the lost accounts had a change in chief investment officer, most of the firms had a core benchmark and several of firms were very focused on what Brown Capital had done for them recently. Mr. Brown went into some detail regarding the loss of clients, the implications for the firm and the firm's strategy for growing assets. Mr. Larkin asked if Brown Capital has had any new investors since June 30, 2005, to which Mr. Brown said that they had not, but did have several in the pipeline. Treasurer Nappier asked if Brown Capital has lost any investors since June 30, 2005, to which Mr. Brown responded that they had lost one account and that it was reflected in the report presented today. Mr. Larkin questioned the significant turnover in sales and purchases of shares. Mr. Brown said that the turnover was because of the reduction in account funds.

### **Roll Call of Comments on Brown Capital Management**

Ms. Thomas said that she would be very comfortable continuing with Brown Capital. Mr. Roth said that at this point he would stay with Brown Capital. Mr. Palmer said that she would agree and stay with Brown Capital. Mr. Thor said that he agreed to remain with Brown Capital. Mr. Bacewicz said that he also agreed. Mr. Himmelreich said that he could forgive performance in 2002 and 2003, but 2004 makes him question their underperformance and that he would watch them very carefully. Mr. Freeman said that he was comfortable with the consensus. Mr. Larkin said that CRPTF should stay with them a while longer. Chairman Roberts said that he thinks CRPTF should stay with them and keep them on the Watch List.

### **Citigroup Asset Management/TIMCO Portfolio Review**

TIMCO provided the IAC with a review of the portfolio it manages for the CRPTF. TIMCO was represented by Dan Willey, President & CEO; Lillyn Teh, Director, Head of Quantitative Research; John Lau, Director, Portfolio Manager; and Jonathan Fischer, Managing Director, Institutional Sales & Client Services. Mr. Fischer made introductions. Mr. Lau provided a detailed performance review.

Because the performance numbers were gross of fees, Ms. Thomas asked what the net of fees performance is. Mr. Lau said to subtract approximately 40 basis points for net of fees.

Mr. Roth asked what TIMCO has done to correct the underperformance or flat performance that has occurred for the past five years. Mr. Lau said that the topic has been debated within their management group but that they are reluctant to react based on two years of performance nor do they want to do nothing. Mr. Lau said that they look at the full economic cycle.

Ms. Teh spoke in some detail about the research done at TIMCO including stock selection models, risk management, quantitative analysis and stock selection and business cycles.

Mr. Willey provided an overview of the Legg Mason transaction and how TIMCO might best fit within the new company. Mr. Larkin questioned who would be managing CRPTF's account once the transaction with Legg Mason is complete. Mr. Willey said that it would be the current manager because they have an investment management agreement with the State of Connecticut Treasury.

Mr. Larkin observed that TIMCO provided a great deal of information about the research that is done at TIMCO and very little about performance. There was a subsequent discussion and exchange of comments regarding performance.

#### **Roll Call of Comments on TIMCO/Citigroup Asset Management**

Ms. Thomas asked CRARC for a current assessment of TIMCO. Ms. Etienne said that CRARC would recommend disassociation.

Ms. Thomas said that she would disassociate. Mr. Roth said that he was completely underwhelmed and noted that TIMCO did not address key issues even when pushed. Ms. Palmer said that she would terminate them. Mr. Thor said that he would not recommend them. Mr. Bacewicz agreed with Mr. Thor. Mr. Himmelreich said that their system is not working, people are leaving and he would hate to be the last one left to turn out the lights. Mr. Freeman said that they have a fourteen-year-old model that is not working and they refuse to fix it. Mr. Larkin said that he could add very little to the comments and that CRPTF should disassociate. Chairman Roberts said that they are over paid at 40 basis points and that CRPTF should terminate the relationship.

#### **Securities Lending Review**

Jeffrey Trencher of State Street Corporation ("State Street") provided the IAC with a review of the securities lending program it manages for the CRPTF. Mr. Trencher is the Securities Lending Account Manager for the State of Connecticut. Mr. Trencher provided a relationship summary, an overview of the securities finance division and their function within State Street, a summary of the securities lending product, performance summary, information on collateral management and information on risk management.

Chairman Roberts asked if CRPTF does any business with Refco. Mr. Trencher said they might be on the list, but would have to check.

Mr. Roth asked if the indemnification of 102% to 105% collateral is the main source of security for CRPTF. He wanted to know, if the collateral is not sufficient, does State Street make up the difference and, if so, does State Street have insurance if it cannot make that payment. Mr. Trencher said that there is not a policy on defaults and CRPTF relies on State Street's credit if there is a shortfall, noting that State Street is an AA rated institution with \$5+ billion in capital.

Mr. Himmelreich expressed a concern regarding whether contingency plans are in place in the event the securities lending markets were to suffer a melt down. Mr. Trencher said that in the United States, State Street only deals with SEC<sup>2</sup> registered broker/dealers and does not deal directly with hedge funds. He said that State Street has indirect exposure through its relationship with Morgan Stanley and that there is a process for vetting, credit limits assigned and legal protections against defaults.

Ms. Miller asked Mr. Trencher to (a) clarify what happens to the right to vote the proxies on the securities that are loaned and (b) if State Street is willing or able to change the contractual terms so that CRPTF could arrange to vote those proxies. Mr. Trencher explained that it would be operationally impossible to obtain proxy-voting rights noting, however, that securities may be pulled back for a particular vote. Ms. Sweeney added that we have that ability in the contract just negotiated with State Street in the event that there is an action CRPTF wants to pursue.

Treasurer Nappier referred to page 19 in the State Street Report regarding the Reinvestment Guideline Comparison and asked if State Street would advise a client with regard to guideline changes that would be in the best interest of the client. Mr. Trencher said that State Street does do so. Treasurer Nappier asked if the State of Connecticut guideline of 90 days net for maximum weighted average maturity is typical of a pension fund of CRPTF's size. Mr. Trencher said that it is not a typical guideline but added that he thinks it is a better guideline because interest rate risk exists between the asset maturity and the liability maturity. Treasurer Nappier asked if the State of Connecticut's 20% limit on US Agency STRIPS is typical. Mr. Trencher said that it is probably not typical, but is probably not a constraint. Treasurer Nappier said that CRPTF should review securities lending investment guidelines every three or four years and make any necessary adjustments.

### **Report on Corporate Governance and MacBride Compliance**

Ms. Miller reported on the Treasury's activities related to corporate governance and MacBride compliance for the period ending June 30, 2005. She provided a summary of statistics for both domestic proxy voting and global proxy voting and reported that there have been no violations of the MacBride Principles.

Ms. Miller said that the Policy Unit has been involved in a number of corporate governance activities related to climate risk, which include discussions that have begun and will be ongoing with Joe Boren, President of AIG. She said that there are many institutional investors that have joined the discussions initiated by the OTT with AIG on the impact of climate risk. Ms. Miller said that Mr. Boren would be one of the speakers at the upcoming Connecticut Global Climate Change Summit referred to earlier today by Treasurer Nappier. She distributed copies of the

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<sup>2</sup> Securities and Exchange Commission

invitation, agenda and an RSVP form for any IAC member interested in attending the summit. Treasurer Nappier said that climate change poses a potential risk to insurance companies in terms of the companies they insure as well as the assets invested and managed by the insurance companies. Treasurer Nappier said that insurance industry assets are invested in companies that could be directly impacted by climate change and that it is important that the insurance industry begin to look at this issue and appeal to the companies that they insure to begin assessing their potential liabilities.

Ms. Miller said that a coalition of public funds, which includes Connecticut, has begun discussions with Wal-Mart regarding internal controls to examine compliance with domestic and global labor standards.

Ms. Miller said that the Policy Unit is in the process of planning the 2005/2006 proxy-voting season and working to identify the issues, companies and dialog. She said that she would present that information in the next Corporate Governance quarterly report.

#### **Quarterly Update on CRPTF Cash Flow as of June 30, 2005**

Before Greg Franklin, Assistant Treasurer- Investments, began the update on CRPTF Cash Flow he commented on the fees that TIMCO indicated they were being paid by CRPTF. He noted that TIMCO is paid fees based on performance and he does not know where they came up with 40 basis points. He said that they receive a 10 or 20 basis points base fee plus a performance fee, which they have not earned recently. Mr. Franklin said that the OTT met with the same group of people from TIMCO a couple of times regarding their performance and the meetings were very different from the meeting today. Treasurer Nappier said that TIMCO was invited to present to the IAC subsequent to meetings that she, Ms. Sweeney and Mr. Franklin had with the TIMCO representatives and that during those meetings, TIMCO indicated that the firm had made some changes and was on the road to recovery.

Mr. Franklin provided an update on CRPTF cash flow through June 30, 2005, noting that CRPTF began fiscal year 2005 with \$365 million of cash and as of June 30, 2005, had \$394 million of cash. He noted that CRPTF's original cash balance estimate for June 2005 was \$155.3 million, but actual cash flow resulted in the generation of an additional \$239 million. The primary reason for this increase in cash was that CRPTF had forecasted the funding of more real estate activity than what was realized. In addition, CRPTF received more cash from private equity than what was estimated. He said that the net of contributions and pension benefit transfers was negative \$943 million and sweeps of dividends and interest were a positive \$859 million.

Treasurer Nappier brought up the issue of efficiency of the management of the cash flow and whether the cash at the end of the fiscal year, as well as on a monthly basis, is what CRPTF aims to maintain. Mr. Franklin said that at the beginning of the year CRPTF is conservative in estimates, taking into account contributions and disbursements, purchases and sales in the private equity and real estate markets and expectations of interest rates. He said that during fiscal year 2005, CRPTF under estimated what would happen in the real estate market and there were additional proceeds from the private equity market. Treasurer Nappier said that half a billion dollars is a lot of money to manage in the cash management system used at the OTT. A

discussion followed relative to what an appropriate amount of cash would be for CRPTF to maintain and the way in which the cash is managed.

**Other Business**

**Status Report on Requests by IAC Members**

Ms. Sweeney said that a draft of the **Diversity Principles** has been written. She said that there had been a meeting with Treasurer Nappier and that the document is currently being edited and revised with the help of Ms. LaMarr.

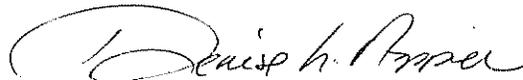
**Discussion of Preliminary Agenda for November 9, 2005 IAC Meeting**

Ms. Sweeney said that there is one private equity fund currently being reviewed and might be invited to provide a presentation. She said there is nothing else at this time. She said the meeting is scheduled for November 9, 2005 and that there is an Asset Liability meeting scheduled for November 14, 2005.

There being no further business, the meeting was adjourned at 1:55 P.M.

An audio tape of this meeting was recorded.

Respectfully submitted,



**DENISE L. NAPPIER**  
**SECRETARY**