INVESTMENT ADVISORY COUNCIL
WEDNESDAY, October 13, 2004

MEETING NO. 319

Members present:	John Bacewicz, representing Marc S. Ryan James Larkin Denise L. Nappier, Treasurer Sharon Palmer Henry E. Parker Clarence (Dick) L. Roberts, Jr., Chairman David Roth Carol Thomas
Absent:	Reginald Martin
Others present:	Howard G. Rifkin, Deputy Treasurer Susan B. Sweeney, Chief Investment Officer Pamela Bartol, Assistant Investment Officer Patricia DeMaras, Associate Counsel Greg Franklin, Assistant Treasurer-Investments Donald Kirshbaum, Investment Officer Catherine E. LaMarr, General Counsel Meredith Miller, Assistant Treasurer-Policy David Scopelliti, Principal Investment Officer Judy Balich, Executive Secretary Sarah Carter, Administrative Assistant
Guests:	Sean Quigley, State Street Corp. Maria Luce, State Street Corp. Thomas Woodruff, Office of the Comptroller Cynthia Steer, CRA RogersCasey Bradley Atkins, Franklin Park Vonda Brunsting, Service Employees International Union Harvey Kelly, Leumas Advisors Julie Naunchek, CSEA-Retiree Council #400 Robyn Kaplan-Cho, Connecticut Education Association

Chairman Dick Roberts called the meeting to order at 9:13 A.M.

Approval of Minutes

Chairman Roberts asked for comments on the Minutes of the September 8, 2004 Investment Advisory Council ("IAC"). David Roth cited a correction that should be made on page 5, third paragraph, first sentence "Ms. Palmer asked if BNY…" BNY should be changed to State Street. Chairman Roberts requested that page 5, third paragraph second sentence under Presentation by Mellon Global Securities Services be clarified by changing "…these are definitive plans." to read "…there are definitive plans to improve their corporate diversity." **A motion was made by Mr. Roth, seconded by John Bacewicz, that the Minutes of the September 8, 2004 IAC meeting be accepted with the amendments noted above. The motion was passed unanimously.**

Opening Comments by the Treasurer

Treasurer Denise Nappier noted the Treasurer's Annual Report for Fiscal 2004 is in the process of being completed for required submission to Governor Rell this Friday, and that she would therefore be prepared to present an overview of fiscal 2004's milestones and achievements at the IAC meeting in November.

Treasurer Nappier explained that she is tabling the item regarding CRA RogersCasey that had been scheduled for today regarding consultants "pay-to-play" practices because it is really an industry-wide issue, and certainly not restricted to CRA RogersCasey. She said that her staff would prepare and deliver a report to the IAC on the practices in the consulting industry at a future meeting.

Treasurer Nappier reported that staff from both Pension Funds Management and Cash Management made site visits to Bank of New York, State Street Bank and Mellon Financial. She said that once a few follow-up items currently being analyzed are completed, she will review all of the data and recommendations from her staff and the consultant and make a decision on the preferred master custodian.

Treasurer Nappier said that her office issued a press release regarding the Office of the Treasurer's ("OTT") intent to sell the Goodwin Hotel and office tower and that the release had been necessary, although a little premature, because the media had picked up on the fact that something was going on at the Goodwin. She said that AEW, the investment advisor, has contracted with CB Richard Ellis, a broker, and they have retained Suzanne Hopgood, a local consultant, to assist with the marketing of the property. Treasurer Nappier said that she understands that this process is expected to take several months.

Treasurer Nappier reported that following the June 18th presentation by Charterhouse Equity Partners ("Charterhouse"), she and her staff conducted extensive discussions with the firm's principals regarding their workforce diversity profile and plans to address this issue as they grow. She said that she is satisfied that Charterhouse understood the OTT's position on the matter and would make a genuine and concerted commitment to this important issue. Noting that the 45-day comment period expired on August 2, Treasurer Nappier said she has decided to proceed with a $75 million commitment to Charterhouse pending successful contract negotiations.

Treasurer Nappier reported that the OTT reached a settlement with Forstmann Little and they have agreed to pay the OTT $15 million and returned $1.2 million that they withheld from distributions earlier this year in anticipation of using that money to cover their own legal expenses.

James Larkin and Chairman Roberts commended Treasurer Nappier and her staff for their magnificent job in settling the Forstmann Little matter.

Chairman Roberts noted that he met with the auditor prior to the IAC meeting today and was told, informally, that there are no problems relative to the Pension Funds or the OTT. He said that there would be an audit committee meeting immediately preceding the November IAC meeting and Reginald Martin will report on the audited financials.

Chairman Roberts spoke briefly regarding a workshop that he and Deputy Treasurer Howard Rifkin attended at the John F. Kennedy School of Government at Harvard University. He said that Professor John Holdren of Harvard University gave a presentation of *Risks from Global Climate Change*. He said that when Mr. Rifkin receives a copy of the presentation, it would be forwarded to the members of the IAC. Chairman Roberts said that it is well worth reading and that part of the purpose of corporate governance is to bring the global warming risks to the fore with the use of proxy statements.

CRPTF Final Performance for August 2004

Susan Sweeney, Chief Investment Officer, reported that for the month of August the Fund had a modest return of about 78 basis points, slightly under performing the benchmark by about 24 basis points. She noted that each of the managers did under perform slightly, but this is not a long-term trend. She also said that there are a couple of managers that are being closely monitored because they have under performed for a period of time. Mr. Larkin and Mr. Roth engaged in a conversation with Ms. Sweeney regarding the process used by Pension Funds Management for monitoring managers. Ms. Sweeney explained the process and also talked about the current undertaking to draft a watch list policy. Treasurer Nappier indicated that the consultant reacts immediately to notable situations involving a manager. Mr. Rifkin also noted that there are some guidelines in the Investment Policy Statement. He remarked that CALPERS has made a conscious decision to move away from the use of a watch list and to give their chief investment officer and staff the authority to terminate a manager. Treasurer Nappier said that the OTT does have the authority to react immediately. Mr. Roth asked if managers are required by contract to report significant personnel changes to OTT. Ms. Sweeney explained the process used by managers to notify OTT. Mr. Larkin then wanted to know if managers with a large turnover rate are also watched. Ms. Sweeney assured Mr. Larkin that significant staff turnover of a manager is also monitored.

Report on Corporate Governance and MacBride Compliance

Meredith Miller, Assistant Treasurer for Policy, reported on the Treasurer's activities related to corporate governance and MacBride compliance for the period ending June 30, 2004. Ms. Miller provided summaries of the domestic proxy voting report and the international global proxy voting analysis. She also provided a summary on various successes during the 2004 proxy-voting season.

Donald Kirshbaum, Investment Officer, gave an overview of the history at American Electric Power ("AEP") that led to the recent agreement with Treasurer Nappier in which AEP agreed to have a committee of independent board members assess the actions of the company relating to significant reduction of carbon dioxide and other emissions and issue a report to shareholders.

Ms. Miller provided an overview and update of Disney issues.

Ms. Miller also reported that all domestic and fixed income managers are in compliance with the MacBride Statute. She said that Pam Bartol, Assistant Investment Officer, had successfully negotiated, in conjunction with New York City, to bring AIG and Coca Cola into compliance.

Quarterly Update on CRPTF Cash Flow as of June 30, 2004

Greg Franklin, Assistant Treasurer-Investments, gave an update on CRPTF Cash Flow as of June 30, 2004, noting that for the fiscal year end, contributions were $1,005 million and benefit payments were $1,832 million with a net outflow of $827 million.

Mr. Franklin then reported on cash flow estimates for fiscal year 2005. He said that total contributions are estimated to be slightly over $1 billion, representing a 4% increase over fiscal year 2004 contributions. He also said that total benefit payments are estimated to be approximately $2 billion, which represents a 7% increase over fiscal year 2004 distributions. Mr. Franklin estimated the net outflow from CRPTF for fiscal year 2005 to be approximately $920 million, representing an 11% increase over fiscal year 2004 net outflow. He said that a point to note is that distributions are increasing at a faster pace than contributions. Mr. Roth asked if Mr. Franklin could add a column on the chart that would show the contributions if the various funds were fully funded.

There was a very lively discussion following Mr. Franklin's report relative to contributions, benefit payments and dividend payments. Some highlights of that discussion included Mr. Rifkin pointing out that part of the 2005 projections on contributions are based on a 65% appropriation level for the current teachers' retirement. Mr. Rifkin also noted that the pension fund is being funded at the actuarial requirement for state employees. Treasurer Nappier said that the issue with the non-teachers pension fund is the past service requirement and the amortization schedule that has been elongated, which provoked a side discussion about the amortization schedule. Ms. Sweeney pointed out that one variable mentioned by Mr. Franklin is that cash returns from the private equity portfolio must be estimated and in the last fiscal year some large capital gains were returned to the fund. Ms. Sweeney said that Alignment Capital, in conjunction with Franklin Park, is working to update the pacing study which will provide more data on the estimated distributions. Sharon Palmer believes that the actuarial study will show an increase in the number of teachers who will be retiring over the next few years. Tom Woodruff, the Director of the Retirement and Benefits Services Division at the Office of the Comptroller, informed the IAC that the 4-year actuarial study is scheduled to be complete by October 28, 2004, and he provided a very brief overview of some items that would be included in the report. Treasurer Nappier pointed out that CRARC is scheduled to begin an updated asset liability study upon the completion of the actuarial study. Henry Parker said that positive actions that are taken to ensure appropriate contributions to the retirement fund would be meaningless if the legislature continues to cut contributions whenever there is a shortfall in government funds. Mr. Bacewicz agreed with Mr. Parker and said that he thinks this is going to be a very difficult biennial budget for Governor Rell and the legislature. Mr. Rifkin said that since taking office in 1999, Treasurer

Nappier has recognized the liability and the shortfall of the pension funds as a lurking issue in the state's finances and has, during every legislative session since taking office, proposed various pieces of legislation, including supporting a constitutional amendment proposed by the teachers' union to require the state to fund 100% of what is actuarially required for the teachers' fund. He said that he could assure the IAC that Treasurer Nappier will once again take that message into the next legislative session. Mr. Rifkin also noted that Treasurer Nappier has met with Governor Rell around the issue of the budget and did mention that one of the unrecognized debts that the state has is the under funding of its pension funds. Treasurer Nappier, in pointing out another perspective about the cash flow projection, said CRPTF is maturing and that the reason the state has an investment fund is to help cover pension benefits. Mr. Bacewicz noted that this discussion assumes there will be no change in benefits, especially on the teachers' side, but that there have been bills introduced that have come very close to being passed that would liberalize the number of people who would qualify or payouts over time, which would add hundreds of millions of dollars, short term. Treasurer Nappier said that if a bill of that nature should be passed, the legislature would need to cover the additional cost, which is a separate issue than the 100% contributions.

Other Business

Status Report on Requests by IAC Members

Ms. Sweeney said that she has a draft of the **Parker Diversity Principles** and hopes to have the document for the November meeting, but may not have it until December.

Mr. Scopelliti said that he had given Mr. Roth the requested information from **the Camelot Group** following the September IAC meeting. Chairman Roberts asked if Mr. Scopelliti would share the information with the rest of the committee. Ms. Sweeney said that the rest of the IAC would be provided copies.

As Treasurer Nappier indicated earlier during this meeting, the request that CRA RogersCasey report on **Conference Speakers Who Pay to Speak** would be tabled and that OTT staff would prepare and deliver a report to the IAC on the practices in the consulting industry at a future meeting.

There being no further business, the meeting was adjourned at 10:25 P.M.

An audio tape of this meeting was recorded.

Respectfully submitted,

DENISE L. NAPPIER
SECRETARY