

VERMONT STATE EMPLOYEES' RETIREMENT SYSTEM

Meeting of the Board of Trustees

May 19, 2005

Members present:

WARREN WHITNEY, Chairperson, VSEA member (term expiring September 2006)
ROBERT HOOPER, VSEA member (term expiring September 2006)
CATHERINE SIMPSON, Alternate VSEA member (term expiring September 2006)
JEB SPAULDING, Vice-Chairperson, VT State Treasurer
STEVE GOLD, Representing JAMES REARDON, Commissioner of Finance & Management
LINDA McINTIRE, Commissioner of Human Resources
DICK JOHANNESSEN, Governor's Delegate
JANICE ABAIR, Retired Vermont State Employees' Association - **arrived later in the meeting**

Member(s) absent:

WILLIAM HARKNESS, VSEA member (term expiring September 2005)

Also attending:

Cynthia Webster, Director of Retirement Operations
David Minot, Director of Finance and Investments
Elizabeth Pearce, Deputy State Treasurer
Bill Rice, Director of Law and Policy
Dick Charlton, Ellen Griggs, Kevin Kondry, NEPC
Investment Management Personnel

The Chairperson, Warren Whitney, called the meeting to order at 8:12 a.m. on Thursday, May 19, 2005, held in the Suzanna's Restaurant Conference Room at the Hilltop Inn, Airport Road, Berlin, VT.

Mr. Whitney welcomed and introduced Mr. Gold.

ITEM 1: Board Action

- A. Approve the Minutes of April 14, 2005

On a motion by Mr. Hooper seconded by Ms. Simpson, the Board unanimously voted to approve the minutes of April 14, 2005, with the following amendment to Item 6, ... by the VSTRS in March, in non-support of activities, organizations, or financial investment companies that support the ...

- B. Discuss/Approve the Continued Disability Retirement for : Janet Franz

On a motion by Mr. Hooper seconded by Ms. Simpson, the Board unanimously voted to approve the continued disability retirement for Janet Franz, as recommended by the Medical Review Board.

- C. Approve SSgM for International Equity Transition Management

Mr. Minot provided a brief explanation stating the request before the Board was simply an addition to the language in the previously approved transition management contract.

On a motion by Mr. Spaulding seconded by Mr. Johannesen, the Board unanimously voted to add international equity language to the previously approved transition management contract with SSgM.

D. Discuss/Act on Actuary RFP Finalist Presentations

Mr. Whitney advised the Board members present at the finalist presentations took action on Tuesday, to retain Mellon Consulting, and directed staff to initiate fee negotiations.

ITEM 2: Investment Consultant Report for Q1/05 – NEPC

A. Contract Issues

Mr. Minot provided information to assist the Board in a discussion regarding the status of the large cap index management transition, including issues with proposed Trust Agreement language in the commingled SSgA Index contract allocation. He explained language in the Trust Agreement included indemnities and representations that state - the Board's tax-exempt status, authority to enter into a contract, execution of the contract is authorized, and the contract is legally binding. Mr. Rice discussed the "indemnify and hold harmless" language for SSgA and participating funds, and advised the Board on the State's historical position not to endorse contracts with indemnifications.

On a motion by Mr. Spaulding seconded by Mr. Hooper, the Board unanimously voted to authorize proceeding with execution of the contract with SSgA, understanding the indemnification and representation language, as discussed.

Mr. Minot advised the Board he recently learned the PIMCO commingled trust vehicle, previously approved, included a three-party agreement between the system, PIMCO, and the three brokers who would be purchasing future contracts. He explained the agreement contained rather severe language to indemnify against losses in future contracts. He also explained features of an alternative option, to enter into a separate limited partnership agreement vs. the commingled trust agreement, advising the AG's Office would still need to examine and concede to the limited partnership representation and indemnification language.

Mr. Minot distributed details and fee schedules for the PIMCO StocksPLUS, Part A & B investment vehicles. The Board acknowledged the LP contained a performance fee structure, which would be a deviation from the retirement system's past practice in contract negotiations. NEPC verified they were familiar with, and had no problem with PIMCO's Limited Partnership product.

On a motion by Mr. Hooper seconded by Mr. Spaulding, the Board unanimously voted to authorize execution of a PIMCO StocksPLUS Limited Partner, Part B version contract, pending legal approval.

Ms. Griggs advised the Board that NEPC was just informed yesterday by RMK Timber of a Department of Labor problem, and wetlands investment proposal. She explained for the past three years at least one investor in the approximate \$76.2 million fund holds more than the allowable percentage, and the manager was also involved in a potential wetlands venture in Florida.

She advised the Board the manager would be asking for an extension on the current contract to use in the wetlands issue, and allocation arrangement to help resolve the non-compliant, over weighted investor.

ITEM 3: Investment Manager Presentations

Post Advisory – High Yield Fixed Income: Ralph Canada, Director – Relationship Management, appeared before the Board. The high yield portfolio market value was approximately \$54.4 million with a Q1/05 return of (1.0)% vs. the Lehman High Yield Index of (1.6)%; 1-year performance was 5.9% vs. the benchmark of 6.8%; three-year and a five-year performance were not available at this time.

Janis Abair arrived during the next item.

RMK Timberland Group: Jim Webb, Business Development, Gregory Williams, Senior VP and Portfolio Manager, and Dennis Norton, appeared before the Board. The portfolio market value was approximately \$8.4 million with a Q1/05 return of 3.5% vs. the NCREIF Timber Index of 6.0%; 1-year performance was 5.1% vs. the benchmark of 11.2%; three-year return 4.4% vs. the benchmark of 6.6%, and a five-year of 5.9% vs. 3.7% for the benchmark.

The Board was presented a proposal to extend the July 2005 terminating investment, and to remain in the fund for an additional six years, or until July 2011. The extension would be for the purpose of mitigation bank and premium sale opportunities. Mr. Williams advised the Board if they elect not to participate in this option, the return of the system's current term investment would be placed in the cue at the contract's July 2005 termination date, for payment in 2006. Ms. Griggs advised Mr. Williams and Mr. Webb, the Board was told last year there would be no delay in the July 2005 return of funds.

Mr. William explained the DOL prohibitive transaction was created in 2000 when a member of the fund purchased assets of another member. A second proposal to the Board was an option to use a portion of its assets to purchase the non-compliant shares from the fund member, thereby assisting in fund compliance.

Ms. McIntire left the meeting before the motion, and returned during discussion.

At 11:40 a.m. on a motion by Mr. Hooper seconded by Ms. Simpson, the Board entered into executive session, pursuant to Title 1 §313 to discuss contract issues.

Mr. Rice, Mr. Minot, Mr. Charlton, Mr. Kondry, Ms. Griggs, and Ms. Holden were invited into the executive session.

At 12:03 p.m. the Board exited executive session.

On a motion by Mr. Hooper seconded by Mr. Johannesen, the Board unanimously voted to direct the Chair, or designee, to approach RMK to proceed with a two stage liquidation process of holdings, and for the AG's Office, and/or their designee, to approach other fund participants with respect to protection of assets, visa vie the Department of Labor issues

discussed. Mr. Hooper, Mr. Johannesen, Mr. Spaulding, Mr. Whitney, Ms. Simpson, Ms. McIntire, and Mr. Gold voted yes. Ms. Abair abstained.

ITEM 4: Review/Discuss Environmental Manager RFI Results

The Board briefly discussed the RFI results, and agreed to proceed with a formal RFP.

On a motion by Mr. Spaulding seconded by Mr. Hooper, the Board unanimously voted to appoint the Chair, or his designee, and one other Board member to a subcommittee to work with Treasurer's Office staff, NEPC, and members of the VSTRS Board, to review the 35 RFI responses, select an undetermined number of firms to respond to a formal RFP, and develop the RFP criteria, with the understanding the Board has not committed to an allocation at this time.

ITEM 2: (CONTINUED) Investment Consultant Report for Q1/05 – NEPC

B. Investment Policy Guideline Review/Approval

Ms. Griggs led the Board in a review of guideline amendments suggesting an unprepared change to Part A, page 19, to add "Fitch" to the rating agencies listed in the second bullet point. By consensus the Board agreed. She also reviewed amendments to Part B, Investment Manager Guidelines, pages 3-5, 8-10, and page 12.

On a motion by Mr. Spaulding seconded by Mr. Johannesen, the Board unanimously voted to adopt the Investment Policy Guideline amendments, as submitted by NEPC, with the exception of B3, PIMCO, to be addressed at a later date.

C. Quarter 1/2005 Review

Mr. Charlton, Mr. Kondry, and Ms. Griggs reviewed the first quarter 2005 performance. They reported the market value of the fund balance at approximately \$1.104 billion and a gross quarterly return of (1.1)%, an under performance of the (1.0)% median public fund. The one-year return was 7.2% vs. the median public fund at 6.6%, three-year return 7.6% vs. the median public fund at 6.8% and a five-year return of 206% vs. 3.5%.

ITEM 5: Discuss/Act on Board's Position Regarding Social Security Privatization

On a motion by Mr. Hooper seconded by Ms. Simpson, the Board unanimously voted to return the item tabled on April 14, 2005, to the Board for discussion.

Mr. Spaulding reviewed the resolution modeled after the resolution adopted by the VSTRS in March.

Ms. Pearce arrived at the meeting.

Mr. Hooper made a motion seconded by Ms. Simpson, to adopt the resolution as presented by the State Treasurer.

Discussion on the motion ensued regarding political, fiduciary, and personal opinions.

Upon discussion Mr. Hooper withdrew his original motion, and Ms. Simpson withdrew her second to the motion.

On a motion by Mr. Hooper seconded by Ms. Simpson, the Board unanimously voted to table action on this item, to a later date.

With the Board's permission the following item was taken out of order.

ITEM 6: Executive Staff Reports

A. State Treasurer

Mr. Spaulding advised the Board negotiations toward unitization were continuing with a proposal to include all Board members, creating a seventeen-member Pension Investment Committee (VPIC). He said nine members would be required for a quorum and/or action, and the chair position would rotate among the three Boards. The final proposal may also require a minimum number of representatives from each Board be present as part of the quorum.

On a motion by Ms. McIntire seconded by Mr. Hooper, the Board unanimously voted to accept the current unitization compromise, which includes the entire original proposal with an exception to change the Committee composition.

Mr. Spaulding left the meeting.

ITEM 7: Great-West Q1/05 Deferred Compensation Report

Karl Kroner appeared before the Board. He reported a Q1/05 asset balance of \$185.54 million with 5,749 members, of which 5,331 were State and 418 were Municipal employees. The Plan's average account balance was reported at \$32,273 with average contributions per member at \$1,175.

Mr. Kroner agreed to provide more detailed information regarding member participation in the large cap funds, as well as Plan withdrawal information. The Board discussed continued frequent trading issues, and whether the Board should, or needs, to develop a policy regarding the number, and/or frequency of infractions, and ramifications. Mr. Kroner will also include a list of all municipal entities participating in the Plan annually, in the June 30th quarterly report.

The Board generally discussed items including automatic enrollments with opt-outs, employee orientation process, etc. Mr. Kroner will contact the Chair to coordinate a informational presentation regarding potential Plan changes to allow IRAs, Roth IRAs, etc.

Mr. Gold left the meeting.

ITEM 8: Any other business to come before the Board

Mr. Whitney advised the Board with the action to retain Mellon Consulting; it would be prudent to conduct an audit of the actuary. Ms. Webster advised the VSTRS Board approved an action with a timeframe to begin the audit by December 1. Ms. Pearce will investigate Bulletin 3.5 requirements regarding the appropriate RFP process.

On a motion by Mr. Hooper seconded Ms. McIntire, the Board unanimously voted to initiate a process to enable contracting with a firm to audit of the current actuary.

ITEM 9: Contracts and RFPs – Process and Updates

A. Investment Consultant RFP

Mr. Whitney said he felt with an impending, potential development of a VPIC, the Board might consider instructing the Treasurer's Office to initiate a Bulletin 3.5 waiver for a one-year extension of the current Investment Consultant's contract.

On a motion by Mr. Hooper seconded by Mr. Johannesen, the Board unanimously voted to instruct the Treasurer's Office to submit a Bulletin 3.5 waiver request to the appropriate authority, for a one-year extension to the current Investment Consultant contract.

Ms. Pearce distributed a copy of a May 16, 2005, SEC report regarding findings and examinations of select pension consultants.

B. Re-Engineering Project

Ms. Pearce provided an update of the re-engineering project, which is currently on time and under budget. Also provided were drafts of RFP documents, and Advisory Committee information.

C. Future RFPs and Contracts

Ms. Pearce advised the Board SDIA third-party administration RFP responses were still under review. She explained some costs, such as Retirement Office staff time historically had never been, but should be, expensed to the SDIA plan. She said an inclusive calculation of all plan expenses was being prepared, to compare to the responses. Ms. Pearce noted including all expenses in third-party administration, whether contracted or conducted in-house, would definitely have an impact to the participant's rate of return. She said the Board would be kept advised.

Ms. Pearce advised the Board of the results of the §457 Deferred Compensation Plan internal audit RFP, issued pursuant to prior Board approval.

On a motion by Mr. Johannesen seconded by Ms. McIntire, the Board unanimously voted to authorize the expenditure of \$52,200 for the purpose of a §457 Plan audit.

ITEM 6: (CONTINUED) Executive Staff Reports

B. Director of Finance & Investments

Mr. Minot advised the Board the first quarter proxy voting reports from ISS were examined revealing that manager compliance with the adopted Proxy Voting Guidelines was less than 100%. Mr. Minot suggested an option to expecting managers to completely adhere to the Policy, would be to engage ISS to vote proxies on behave of the systems, for domestic large cap managers and potentially add small cap and international money managers. He said an estimated \$40K cost might be expected in exchange for near total compliance with the Policy. Mr. Minot will prepare a formal proposal for the Board to consider at a later date.

Mr. Hooper made a motion seconded by Mr. Johannesen, to authorize the Treasurer's Office to move forward with an expanded contract with ISS. Upon discussion, the motion and second was withdrawn.

The Board agreed to wait for a report and further information from the Treasurer's Office.

Mr. Minot also advised the Board there was a delay in writing the new real estate managers' contracts with REFF America, and Transwestern, which also have indemnity language that required legal consultation.

C. Director of Retirement Operations

Ms. Webster provided a legislative update on bills H.133 and H.145, since publication of her executive report. Also distributed was a draft of a comprehensive bill created by the Treasurer's Office encompassing, among other items, prior H.145 and H.238 amendments, demonstrating long term costs proposals of approximately \$45 million over twenty-five years, and development of a Group G plan. Ms. Webster said, however, long-term savings also represents significant savings.

ITEM 8: (CONTINUED) Any other business to come before the Board

Ms. Pearce informed the Board of a recent conversation with Mr. Driscoll of Mellon Consulting regarding contract negotiations. She said, provided the Retirement Office supply year-end data by August 31, the following costs concessions would apply: valuations reduced by \$1,500, statements reduced by 50%, and experience study reduced 10%.

Mr. Whitney reminded members interested in attending the Green Mountain Summit Conference in Stowe, or NEPC's Client Conference to contact Ms. Webster. He also asked members interested in attending either the NAGDCA, NASRA, or NAST conferences to notify him.

Mr. Whitney advised the Board when the time was appropriate; the Chairs from the three retirement systems would participate in reviewing the Retirement Re-engineering Line of Business RFPs. He invited other interested members to participate, also.

Next Meeting Dates:

The next meeting of the Board will be June 9, 2005
The next scheduled quarterly investment meeting is August 18, 2005.

Adjournment:

On a motion by Ms. Pearce seconded by Ms. McIntire, the Board unanimously voted to adjourn at 4:10 p.m.

Respectfully submitted,

Donna Holden, Board Coordinator
for
Cynthia Webster, Secretary to the Board