

VERMONT MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM

Meeting of the Board of Trustees

February 15, 2005

Board members present:

STEVEN JEFFREY, Chairperson, Employee Representative (term expiring July 1, 2007)

DAVID LEWIS, Employer Representative (term expiring July 1, 2006)

MARIE DUQUETTE, Governor's delegate

JEB SPAULDING, State Treasurer

W. JOHN MITCHELL, II, Vice-Chairperson, Employee Representative (term expiring July 1, 2005)

Also attending:

Cynthia Webster, Director of Retirement Services

David Minot, Director of Investment Services

Dick Charlton, Ellen Griggs, Kevin Kondry, NEPC

Investment Management Personnel

The Chairperson, Steve Jeffrey, called the meeting to order at 9:17 a.m. on Tuesday, February 15, 2005, held in the Suzanna's Restaurant Conference Room at the Hill Top Inn, Airport Road, Berlin, VT.

Mr. Mitchell arrived during the next item.

ITEM 1: Treasurer's Report

Mr. Spaulding reviewed his written report. He reported on pending unitization legislation, disability statistics, and the status of an upcoming environmentally conscious manager RFP for a potentially small allocation by the Teacher and State systems.

Mr. Spaulding also advised the Board the Attorney General's Office would be conducting an RFP to seek a firm to monitor class action suits, and provide reporting. The Board will be kept advised of the results.

ITEM 2: Director of Retirement Operations Report

A. Legislative Initiatives

Ms. Webster and the Board reviewed pending statute amendments.

On a motion by Ms. Duquette seconded by Mr. Lewis, the Board voted to approve the amendments to 24 V.S.A Chapter 125, as submitted by the Retirement Operations Director, with additional clarification, and provision for AFC cost-of-living increases, in §5057(c). Mr. Spaulding, Mr. Jeffrey, Mr. Lewis, and Ms. Duquette voted yes. Mr. Mitchell voted no.

Ms. Webster asked the Board whether an employee who works less than 30 hours per week, however works year round, could be included in the system's membership.

The Board instructed Ms. Webster to send a letter to school boards and union representatives to gather additional information on the issue. Ms. Webster agreed and will report back to the Board.

Mr. Spaulding reported that a meeting with Mr. Jeffrey and union representatives, Ralph Crippen and Joel Cook, was held to discuss concerns with the statutory language of employee/employer representatives elected to the Board. He said as a result of their discussion, an alternative to resolve concerns included changing the Board make-up to 2 employee members elected by employees, 2 employer members elected by employers, and the State Treasurer. The Governor's appointee would be eliminated, unless the Board preferred to move to a 6-member panel, including the Governor's appointee. The Board discussed the pros and cons of a 6-member Board and opinions of whether to present a bill to amend the statutory language. Further discussed included the potential veto of a bill by the Governor, who would object to losing the current seat on the Board.

On a motion by Mr. Spaulding seconded by Mr. Lewis, the Board voted to draft a separate bill to amend § 5062 language to an alternative Board make-up, and to retain the 5-member Board structure. Mr. Spaulding, Mr. Jeffrey, Mr. Lewis, and Mr. Mitchell voted yes. Ms. Duquette voted no.

Mr. Spaulding explained that specific transition language would be included in the proposal.

B. ICMA-RC Analysis Report

Ms. Webster distributed information obtained from ICMA-RC regarding retirement health savings plan options and discussed additional information received from Mellon Consultants. The Board also discussed the nuances of 401(H) and Section 115 plans. The Board agreed to hold a meeting soon devoted to their fact-finding of this issue, and continue option discussions.

The Board discussed and agreed to expand language of §5069 to also permit use of excess funds, if a health savings plan was established. Ms. Webster will work with Legislative Council.

The Board discussed the laws regarding employee transfers between retirement systems and elected to include a discussion of discrepancies on a later agenda. Ms. Webster will prepare background information for the Board.

ITEM 3: Board Action Items

A. Approve the Minutes of December 28, 2004

On a motion by Mr. Mitchell seconded by Ms. Duquette, the Board unanimously voted to approve the minutes of December 2, 2004, as submitted.

B. Approval of Membership to VMERS: Town of Orwell

On a motion by Ms. Duquette seconded by Mr. Mitchell, the Board unanimously voted to approve the membership of the Town of Orwell into Group B, effective April 1, 2005.

At the Board's request, Ms. Webster will include a copy of the letter signed by new entities regarding income-reporting requirements.

C. Approve 2005 Election Rules & Regulations

On a motion by Mr. Mitchell seconded by Ms. Duquette, the Board unanimously voted to approve the Annual Election Rules & Regulations for the 2005 election.

ITEM 4: Investment Consultant Report for Q4/04 – NEPC

Mr. Charlton, Mr. Kondry and Ms. Griggs reviewed the fourth quarter 2004 performance. They reported the market value of the fund balance at approximately \$239.7 million and a gross quarterly return of 7.1%, an under performance of the 7.6% median public fund. The one-year return was 10.1% vs. the median public fund at 11.0%, three-year return 7.1% vs. the median public fund at 7.3% and a five-year return of 4.7% vs. 4.1%.

Ms. Griggs discussed concerns with Lazard Asset Management as a result of several changes in personnel, and poor performance due to their stock selection process, which was the foundation of their value added product. She advised that NEPC would soon be issuing a letter to their clients who employ Lazard Asset Management outlining the concerns and proposing a 9-month window for the manager to make improvements with respect to the issues. Further proposed was NEPC's recommendation to place the manager on a short-term watch list.

Ms. Griggs discussed issues regarding the SSR Tower Fund portfolio. She suggested the Board consider a number of options, which included initiating a new manager search; discuss transition management with UBS Realty, and initiating withdrawal requests, with an option of withdrawing from the queue, if the manager provided substantial improvement.

ITEM 5: Investment Manager Presentations

Lazard Asset Management: Patrick Mullin, Director and Portfolio Manager, and Tom Franzese, Director, appeared before the Board. The small cap core equity portfolio was reported to have a market value of approximately \$26.2 million with a Q4/04 return of 11.9% compared to the Russell 2000 Index of 14.1%, 1-year performance was 16.1% vs. the benchmark of 18.3%; three-year return 10.3% vs. the benchmark of 11.5%, and a five-year of 13.1% vs. 6.6% for the benchmark.

The Board was advised that much of the recent publicity about Lazard was regarding an initial public offering (IPO) of approximately 40%, changes in personnel, and inclusion in an industry wide probe into gifts & gratuities; however, the firm was sound, both internationally and domestically.

BlackRock Realty (SSR Tower Fund-MetLife): Jay Alexander and John Loehr, Managing Directors appeared before the Board. The actively managed open ended, commingled, core portfolio of equity real estate was reported to have gross assets of \$6.3 billion of which approximately \$14.4 million of the market value is from the VMERS. The portfolio contained 21 close-ended funds, 52 open-ended funds, and 11 separate accounts. The Q4/04 return was 2.4% compared to the NCREIF Index of 3.4%, one-year return was 6.6% vs. the benchmark of 12.2%, three-year return 5.2% vs. the benchmark of 8.2%, and a five-year return of 6.6% vs. 8.9% for the benchmark.

The Board was advised of the January 31, 2005 sale of SSR Realty Advisors to BlackRock, Inc. Further advised was that the Tower Fund would remain a product of MetLife, sub-advised by BlackRock Realty. MetLife owns a portion of BlackRock, Inc.

ITEM 6: Director of Finance and Investments Report

A. Update of Index Management Fees/Contract Issues

The Board reviewed the final fee proposals from PIMCO, T. Rowe, and SSgA for the new domestic equity index management contracts.

On a motion by Ms. Duquette seconded by Mr. Lewis, the Board unanimously voted to approve the final fee negotiations of PIMCO .324%, T. Rowe .300%, and SSgA .031%, as presented by NEPC, and instruct NEPC to work with the Treasurer's Office to initiate contracts and the transition.

Mr. Minot discussed the proposal to engage SSgM, State Street Global Management, as a sole source entity to handle the ultimate transition functions for the three systems. Additionally reported was that the custodian bank would charge a fee for non-use of their services. NEPC will provide a letter in support of the action to be used along with the Bulletin 3.5 waiver request.

On a motion by Mr. Spaulding seconded by Mr. Mitchell, the Board unanimously voted to approve the request for a sole source engagement of SSgM for the purpose of transition management from the actively managed accounts to the new index managed accounts.

B. Global Bond Search Update

Mr. Minot reminded members of the manager finalists' presentations at 1:30 today. He also advised the Board of the International Equity manager preliminary review tomorrow with the State Teacher's Board.

Mr. Minot also advised the Board of a recent review and modification to the fund line-up in the State's 401(a) DC Plan. The Board agreed to review their changes at the May quarterly meeting.

ITEM 7: Any other business to come before the Board

Mr. Spaulding advised the Board the State Retirement Systems (VSERS, VSTRS, and VMERS) received a nomination for Small Pension Fund of the Year Award from *Money Management Letter*.

The Board resumed the earlier discussion of the recommendations by NEPC regarding the small cap manager.

On a motion by Ms. Duquette seconded by Mr. Lewis, the Board unanimously voted to place Lazard Asset Management on a watch list, and instruct NEPC to notify the manager of their position.

The Board further discussed and advised NEPC to be prepared to conduct a small cap manager search, if needed.

Adjournment:

On a motion by Mr. Mitchell seconded by Mr. Lewis, the Board unanimously voted to adjourn at 1:36 p.m.

Next Meeting Dates:

The Board agreed to hold a meeting on March 15, 2005 (first choice) or March 8, 2005 (second choice), to continue discussions of a prospective health care savings account issue.

The next scheduled quarterly investment meeting will be Tuesday, May 17, 2005.

Future Agenda Items:

Results of AG's RFP follow up – Jeb
Membership criteria follow up – CLW
Employee transfers within Plans discussion – CLW
DC Plan fund line-up review – DM

Respectfully submitted,

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