

VERMONT STATE EMPLOYEES' RETIREMENT SYSTEM

Meeting of the Board of Trustees

February 19, 2004

Members present:

WARREN WHITNEY, Chairperson, VSEA member (term expiring September, 2004)

JEB SPAULDING, Vice-Chairperson, VT State Treasurer

CINDY LAWARE, Commissioner of Personnel

ROB HOFMANN, Commissioner of Finance & Administration

DICK JOHANNESSEN, Governor's Delegate

GORDON MACARTHUR, Retired Vermont State Employees' Association

CATHERINE SIMPSON, VSEA Alternate (term expiring September 2005)

Members absent:

ROBERT HOOPER, VSEA member (term expiring September 2004)

WILLIAM HARKNESS, VSEA member (term expiring September 2005)

Also attending:

Cynthia Webster, Director of Retirement Operations

David Minot, Director of Investment Services

Dick Charlton, Ellen Griggs, Kevin Kondry, NEPC

Joe Healy, Retired Vermont State Employees' Association

William Griffin, Chief Assistant Attorney General

Doug Hoffer, Attorney and Economic Consultant

Rob Kellogg, Institutional Shareholder Services

Mike Casey, Legal Counsel, VSEA

Investment Manager personnel

The Chairperson, Warren Whitney, called the board meeting to order at 8:18 a.m. on Thursday, February 19, 2004 in the Treasurer's Conference Room \$1 at 133 State Street, Montpelier, VT.

ITEM 1: Approval of minutes for February 12, 2004

On a motion by Mr. MacArthur seconded by Mr. Johannesen, the Board unanimously voted to approve the minutes of February 12, 2004, as submitted.

ITEM 2: Investment Consultant Report for Q4/03

Mr. Charlton, Mr. Kondry and Ms. Griggs reviewed the fourth quarter 2003 performance. They reported a market value fund balance of \$1.021 billion and a quarterly return of 8.7%, an out performance of the 8.4% median public fund. The one-year return was 23.4%, three-year return 2.2% and five-year return 4.0%.

Ms. LaWare left the meeting.

A. Discussion of Henderson Global

Because of a dramatic drop in properties and investors, NEPC recommended termination of Henderson Global Investors, effective immediately. The current distribution request would be amended to a termination distribution request and the funds when received would be moved relative to the target allocation, to UBS Realty, an existing manager within the asset class.

On a motion by Mr. MacArthur seconded by Mr. Johannesen, the Board unanimously voted to immediately terminate Henderson Global Investors, pursuant with the terms of the contract.

B. Ratify Asset Allocation Structure

On a motion by Mr. Spaulding seconded by Mr. Hofmann, the Board unanimously voted to reaffirm the currently approved target as presented effective 2/19/04, and to add the following Allocation Structure to the Investment Policy Guideline as section D:

Equities		
Large Value	Delaware	9.0%
Large Core	Alliance	10.0%
Large Growth	Baring	9.0%
Total Large Cap		28.0%
Small Value	Rothchild	6.0%
Small Growth	SSGA R2000 Index	6.0%
Total Small Cap		12.0%
IE (Estab.)	UBS	8.0%
	Lazard	8.0%
Total IE		16.0%
Alternative Investments	VC & Wachovia	3.0%
Total Equities		59.0%
Fixed Income		
Core Fixed Inc	Loomis Sayles	23.0%
Market Neutral		0.0%
High Yield		5.0%
Global Fixed Income	Deutsche	7.0%
Total Fixed Income		35.0%
Real Estate	UBS/Hendersen	6.0%
Hedged Strategies		0.0%
Cash		0.0%
Totals		100.0%

C. Appropriate Timing of Rebalancing

Mr. Minot reported that the current schedule for rebalancing, pursuant to the Investment Policy Guidelines, is February and August. His recommendation, in concert with NEPC, is to change the schedule to March and September.

On a motion by Mr. Spaulding seconded by Mr. Johannesen, the Board unanimously voted to amend the Investment Policy Guideline to schedule the semi-annual fund rebalancing to March and September.

Ms. LaWare returned to the meeting.

ITEM 3: Investment Manager Presentations

Deutsche Asset Management: Annette Fraser, Portfolio Manager, and Kieren McGlynn, Client Services, appeared before the Board. The global fixed income portfolio was reported to have a market value of approximately \$73.1 million with a Q4/03 return of 5.1% compared to the CITI WGB index of 5.2%; one-year performance was 15.9%; three-year return was 10.9% and five-year return 5.4%.

Dwight Asset Management – 457 Plan & SDIA: David Thompson, CFA, Managing Director & CIO, Robert Miller, Senior VP of Client Services and Andrew Beaumier, VP and Portfolio Manager appeared before the Board.

The 457 Deferred Compensation SEI stable value asset fund portfolio was reported to have a market value of approximately \$57.1 million with a Q4/03 return of .99%; one-year at 4.58%, three-year 5.64%, and five-year return 6.04%.

The Single Deposit Investment Account (SDIA) portfolio was reported to have a market value of approximately \$35 million with a Q4/03 return of 1.23%; one-year at 4.8%, three-year 6.13% and five-year return 6.84%

Ms. LaWare left the meeting.
Mr. Hofmann left the meeting.

ITEM 4: Director of Finance & Investments Report

A. Securities Litigation Follow-UP

Mr. Minot reported that the AG's Office and BISHCA are working to recover potential losses to pension funds as a result of possible fraudulent and/or bias research by some managers during the 2000-2002 timeframe. He also said the State of Vermont has been registered as a participant in class action law suits against Enron and WorldCom.

Mr. Charlton reported on their recent successful report filed with the Securities Exchange Commission (SEC).

As potential respondents, NEPC personnel stepped out of the room during discussion of the following item.

B. Status of 457 & DC RFP

Mr. Minot reported the RFP has been advertised and posted on multiple web sites. He briefly reviewed the scope of services and advised the submission deadline is March 4, 2004. Members interested in reviewing the responses should notify the Chair.

C. Commission Recapture

Mr. Minot reported that negotiations have resulted in a contract which is being reviewed by the AG' Office and will be sent to the Chair for signature in the near future.

NEPC personnel returned to the meeting.

ITEM 5: Discuss/Act on Proxy Voting Policy

Rob Kellogg of Institutional Shareholder Services appeared before the Board. Mr. Kellogg reviewed and discussed the Proxy Voting Policy.

On a motion by Mr. Spaulding seconded by Mr. Johannesen, the Board unanimously voted to accept the Proxy Voting Policy (draft #4) as presented.

Mr. Whitney advised the Board that Mr. Hooper, who served on the policy sub-committee, was in support of the policy and thankful for the cooperative and speedy development of the policy.

ITEM 6: Treasurer's Report

A. VT Targeted Investment Report

Mr. Hoffer appeared before the Board to discuss the report he prepared at the Treasurer's request in response to a Legislative directive to study and report on how states can appropriately use pension funds for in-state targeted investing.

The Board requested further information from NEPC regarding the asset class and information regarding current managers.

Ms. LaWare returned to the meeting.

B. Money Manager Behavior Policy

The Board reviewed the 2/6/04 proposed *Business Conduct* policy, which has received review and comments by Bill Griffin, Chief Assistant Attorney General.

On a motion by Mr. Spaulding seconded by Mr. Johannesen, the Board voted to adopt the 2/6/04 Business Conduct policy, as written and for it to be included in the body of their Investment Policy Guidelines. Mr. Spaulding, Mr. Whitney, Ms. Simpson, Mr. Johannesen, and Mr. McArthur voted yes. Ms. LaWare abstained.

Mr. Spaulding advised the Board that the Senate passed the Unitization Proposal with no substantive changes and is now in the House. He will notify the Board via e-mail if there are any major changes as it progresses.

ITEM 2: CONTINUED Investment Consultant Report for Q4/03

D. Ratify Investment Policy Guideline

Ms. Griggs distributed NEPC's recommendations regarding Emerging Market Equity (EME) and International Small Cap Equity (IESC) total plan allocation, which included:

Increase allocation to EME and IESC using existing international equity managers.

Lazard current structure:

EME – 15% max exposure

IESC – 10% max exposure

Lazard recommended structure:

EME – 20% max exposure

IESC – 25% max exposure

UBS current structure:

EME – 15% max exposure

UBS recommended structure:

EME – 20% max exposure

At current portfolio market values utilizing **maximum** exposure to the recommended weightings listed above, percentage allocations to EME and IESC would be as follows:

Total EME Plan level exposure – approximately 4%

Total IESC Plan level exposure – approximately 2%

Longwood investment guideline exemption request (Section B of Investment Policy Guidelines)

Currently allowed under existing investment guidelines:
6% max weighting per issue at market value

Recommended change based on Longwood's concentrated portfolio structure:
"Longwood is permitted to invest up to 8% in a single holding (market value)".

On a motion by Mr. Spaulding seconded by Mr. MacArthur, the Board unanimously voted to adopt the 2/19/04 recommendations, as presented.

Ms. Griggs reported that she would amend the Investment Policy Guideline and distribute it to the Board.

ITEM 7: Any other investment related business to come before the Board

Mr. Charlton advised the Board that the NEPC Client Conference would be held in early June. Clients will be notified of the details, soon.

ITEM 8: Director of Retirement Operations Report

A. Retirement Legislative Update

Ms. Webster distributed H.594 regarding allowing certain members of Group C and certain members of Group A and F to participate in the group medical benefit plan after withdrawal from service. There are significant costs associated with the proposal, concerns of segregating separate groups, etc. and the general way the bill is written. This is a very controversial and complex issue with the latest House Government Operation's directive for additional cost estimates for all employees to be eligible for participation, reduced state reimbursement to less than 80%, a mandatory 10 year retirement system membership for eligibility, etc.

Mr. Spaulding left the meeting.

Mr. Johannesen suggested investigating a medical savings plan or other increased co-pay alternatives. Mr. MacArthur objected to the proposal not having a prerequisite of participation in the health care plan as an active employee.

Mrs. Webster distributed a copy of her 2/18/04 memo to the House Government Operations Committee regarding housekeeping language.

Mrs. Webster advised the Board of a potential amendment and minimal cost involved in expanding the timeframe for active employees to apply for a military grant of service credit and payment of retiree stipends based on the Federally expanded timeframe to include the 1,500 nationwide military servicemen that served during the pre-Viet Nam period of 2/28/1961 through 8/5/1964.

B. Disability Hearing Officer RFP

Mrs. Webster advised the Board that five responses were received and would be distributed to the Board Chairs with a matrix for final selection consideration.

ITEM 7: *CONTINUED* Any other investment related business to come before the Board

The Chair advised the Board that he was signing an updated contract with Great-West regarding a name change, a new contract with Longwood, and ISS for the Proxy Voting Policy.

The Chair asked that interested members contact him regarding the NEPC Client Conference.

Mr. Whitney advised the Board that on February 12th, the State of Vermont tied for first place (with Orange County) at the 2003 Pensions and Investments Eddy Awards in the category of "print work" for public plan sponsor retirement plans with more than 5000 participants. P & I's Eddy awards are quite prestigious in the communications world and he thanked Great-West and staff involved in creating the informational materials.

Next Meeting Dates:

The next scheduled conference call meeting is March 11, 2004.

The next scheduled quarterly investment meeting is May 20, 2004.

On a motion by Ms. LaWare seconded by Mr. Johannesen, the Board unanimously voted to adjourn at 3:33 p.m.

Respectfully submitted,

Cynthia L. Webster
Executive Secretary to the Board

GOALS

The Board established the following list of goals to be addressed in the future:

- Form a *Policy Development* sub-committee

TO DO's

<u>Who</u>	<u>What</u>	<u>When</u>	<u>Done</u>
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** = for possible 2004 legislative changes

PD Sub	Complete Proxy voting policy (10/9 item 3)	ASAP	
CLW	Work w/DOP regarding old LOA's (10/9 item 4)	ASAP	
CLW	Obtain AG's opinion re: old LOA's (10/9 item 4)	ASAP	
All	Review Deferred Comp plan document (10/9 item 10)	12/11/03	2/19/04
CLW	457 modified language for members to Board (10/9 item 11)	12/11/03	
CLW	Prepare travel report (10/9 item 12)	11/20/03	
CLW	Advise BenefitsCorp of newsletter info request (10/29 item 2)	ASAP	
CLW	Obtain legal opinion re: real estate assets (11/21 item 7)	12/11/03	