

VERMONT STATE TEACHERS' RETIREMENT SYSTEM

Meeting of the Board of Trustees

January 6, 2005

Board Members present:

JOSEPH MACKEY, Chairperson (Active No. 29334), term expiring July 1, 2005

JON HARRIS, Vice-Chairperson (Active No. 25669), term expiring July 1, 2007

JAY KAPLAN, Association of Retired Teachers of Vermont, term expiring July 1, 2008

THOMAS CANDON, representing Commissioner of BISHCA

VAUGHN ALTEMUS, representing Commissioner of Education

JEB SPAULDING, VT State Treasurer

Also attending:

Cynthia Webster, Director of Retirement Operations

David Minot, Director of Investment Services

Kevin Kondry, New England Pension Consultants – via conference call

The Chairperson, Joe Mackey, called the meeting to order at 8:10 a.m. on Thursday, January 6, 2005, in the Vermont Arts Council Conference Room, 136 State Street, Montpelier, Vermont.

ITEM 1: Approval of the Minutes of November 16, 2004 Joint Meeting November 17, 2004 Quarterly Investment Meeting December 9, 2004 Joint Meeting

On a motion by Mr. Candon seconded by Mr. Harris, the Board unanimously voted to approve the minutes of November 16, 2004, with a correction to page 2: *Mr. Mitchell left the meeting.*

On a motion by Mr. Kaplan seconded by Mr. Harris, the Board unanimously voted to approve the minutes of November 17, 2004, as submitted.

On a motion by Mr. Kaplan seconded by Mr. Harris, the Board voted to approve the minutes of December 9, 2004, with the addition of *Mr. Harris left the meeting on page 4.* Mr. Mackey, Mr. Kaplan, Mr. Spaulding, Mr. Harris, and Mr. Altemus voted yes. Mr. Candon abstained.

The Board discussed the minutes' editing process and by consensus agreed if a member has a critical comment on content or would like additional information added to the record, they would share their comments with the entire Board via e-mail for feedback, before the Chairman decides whether or not to include the comments in the minutes. Typos and minor edits would be provided directly to the Board Coordinator for corrections.

Mr. Kaplan asked if the Treasurer verified the actuary's information as discussed on November 17, 2004 meeting item 8. Mr. Spaulding advised the Board the actuary was preparing a new report, which would include calculation for grandfathering of all members in the data.

ITEM 2: Act on the Disability Retirement for: James Hannah

On a motion by Mr. Kaplan seconded by Mr. Altemus, the Board unanimously voted to approve the disability retirement for James Hannah, as recommended by the Medical Review Board.

The Board discussed and by consensus agreed they only want to receive the Medical Review Board certification and fact-finding documents. Mr. Spaulding would examine the medical evidence and member's file, and report concerns, if any, before the Board takes action.

ITEM 3: Goals and Direction of the Board

The Board participated in a spirited yet respectful discussion regarding the roles of the Board members, Chair, and elected Officials. The Board discussed their "equality of responsibility" and the importance of timely and effective communication and dissemination of information to Board members from the Treasurer and his staff.

Each Board member discussed their perceptions of the Board's functionality, strengths, and perceived reasons for shortfalls or potential conflicts. Pledges were made to work together in a friendly and cooperative manner to assist and assure the Board's success and productivity.

Also discussed were theories of whether the Board "should initiate solutions" for the system's under-funding problem, or whether the Board should only "point out the problem" to the Legislature. Upon discussion the Board's consensus was they should work together to offer viable recommendations to the state, from the whole Board, to help solve the under-funding dilemma, and other issue that impact the Teachers' Retirement System.

Mr. Spaulding outlined some thoughts and suggestions to consider. He suggested - prudent involvement and appropriate action, when necessary, to legislative amendments; to issue a request to the system's actuary for a recommendation of how to best report the GASB 25 under-funding impact; and research the option of having local districts contribute toward retiree health insurance from the State Education Fund.

Mr. Kaplan suggested also investigating the option of offering pension obligation bonds, and changes in statute to force the state to reimburse the VSTRS for expenses, as provided in statute for the State Employees' System.

Mr. Mackey asked the Board to consider how much time should be spent on issues other than under-funding, i.e. large cap satellites, alternative investments, etc. Mr. Altemus felt the Board had a fiduciary responsibility to address investment issues, but also needed to bring the full range of policy and program issues to the table for discussion, including changes in the benefits offered. Mr. Candon agreed, noting the need to examine the funding and liability associated with the dramatically rising cost of health care.

Mr. Spaulding informed the Board he would be fully supporting 2005 legislative action to unify the Boards and create an Investment Committee, as presented in the 2004 session. He said the policy and program issues before the Board were an example of how an Investment Committee would benefit the Boards by freeing up the time for Board members to devote to such critical issues. He will keep the Board advised of any action in that arena.

ITEM 4: Director of Finance and Investments Report

Mr. Minot advised the Board he had researched (with the custodian bank) the question regarding the system's SPIFF/STIFF accounts. He reported that letters with the equity managers indicate a 100% sweep

would occur daily, however, he was still verifying what State Street Bank's practice is. Mr. Minot said he would add Wellington to the list of equity accounts subject to the sweep provisions. Mr. Kaplan felt if the bank was not following the policy, the system should be made whole for any gains the system may have realized, but did not.

Mr. Minot provided information regarding the Board's request to verify proxy-voting issues with indexed accounts. He said proxy voting would occur for separately managed accounts, however, not typically for commingled accounts. The Board reviewed the management fees on page 4 and 5 of NEPC's *Large Cap Allocation Discussion* report. He pointed out that securities lending would not be used for portable alpha accounts, but would be for equal and enhanced products.

ITEM 5: Index Manager Choices and Funding Strategy

The Board discussed their opinions regarding the managers proposed for the index products. Included in the discussion was Mr. Kaplan's disclosure of opposition to hiring a money manager that was known to support privatization of the Social Security Program. Other Board members said they were not inclined to use that reason as a decision maker when selecting a manager, without information and knowledge of the positions of all of the managers.

The Board reviewed and discussed other information provided in the December 2004 NEPC *Large Cap Allocation Discussion* report. Mr. Minot explained the proposed mixes and correlations. He pointed out that mixes J & K were created by NEPC in response to prospective market cycle predictions and the expected lower returns of equal weighted products.

The Board then reviewed several pages of the NEPC *Equal Weighted Portfolios vs. Cap Weighted* report distributed by Mr. Mackey. Mr. Mackey asked the Board to consider and discuss the possibility of a 50%-50% allocation to a portable alpha and equal weighted manager.

Mr. Spaulding made a motion seconded by Mr. Candon, to adopt Mix A as presented with a 33% allocation to PIMCO, 33% to T Rowe Price, and 33% to SSgA.

Mr. Kondry joined the meeting via conference call. Mr. Kondry explained that NEPC's support for T Rowe was based on factors included in the evidence once the comparisons were done, i.e. the manager's performance, and their product management style, importantly the correlation results. He also explained NEPC's position and belief, based on historical data, a cyclical shift in market trends will move away from favoring equal weighted index funds vs. cap weighted index funds for the next cycle.

Mr. Mackey reiterated his suggestion of a 50-50 split, and Mr. Kaplan asked for more fee information from New York Life. Upon further discussion, Mr. Mackey asked for a straw pole on whether the Board would support having two (2) managers rather than three (3), as indicated by the motion on the floor. The straw pole result was Mr. Mackey and Mr. Kaplan for two managers. Mr. Spaulding, Mr. Altemus, Mr. Candon and Mr. Harris for three managers.

Mr. Kaplan called the question.

On a vote of the original motion, the Board approved the adoption of Mix A. Mr. Spaulding, Mr. Altemus, Mr. Candon and Mr. Harris voted yes. Mr. Mackey and Mr. Kaplan, voted no.

Mr. Minot will notify NEPC to begin best & final fees, notify existing manager of the Board votes, and begin the contracting process. With respect to proxy voting, the Board instructed Mr. Minot to consider cost differentials first, and if all things are equal, to opt for contract with proxy voting.

Mr. Kaplan asked Mr. Minot to investigate and report to the Board, the difference (if any), in custodian bank fees for commingled accounts vs. separately managed accounts.

ITEM 6: Environmental Investment Proposal

Mr. Spaulding advised the Board of the VSERS Board decision to move forward with an RFP to seek information from environmentally conscious managers. They would then, upon review and deliberations, consider an allocation to a manager. He asked the Board to consider joining in on the search and participating in the RFP process, with the understanding it was not a commitment to an investment. The Board discussed the proposal.

On a motion by Mr. Spaulding seconded by Mr. Altemus, the Board voted to consider an allocation to an environmentally sound investment strategy, and direct NEPC to conduct an RFP for an environmentally managed US large cap mandate as described in the August 2004 memo. Mr. Spaulding, Mr. Altemus, Mr. Harris and Mr. Candon voted yes. Mr. Kaplan and Mr. Mackey voted no. Motion passed.

ITEM 7: Any Other Business to Come Before the Board

Mr. Altemus said he hoped a process similar to what the Boards achieved in the large cap equity class would occur soon for the bond and fixed income asset classes.

Mr. Spaulding will forward bills and proposed statute amendments to the Board.

The Board discussed items for the February agenda.

Next Meeting Dates:

The next quarterly investment meeting is scheduled for February 16, 2005.

On a motion by Mr. Mackey seconded by Mr. Harris, the Board unanimously voted to adjourn at 11:55 a.m.

Respectfully submitted,

Cynthia Webster
Secretary to the Board

Vermont State Teachers' Retirement System

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

Support full appropriation

BOARD FOLLOW-UP ITEMS

<u>Who</u>	<u>What</u>	<u>When</u>	<u>Done</u>
** = for possible legislative changes			
CLW	Discuss/create policy non-licensed ROTC trainers (3/15/04 #7)	TBD	
CLW	Check w/VEHI or others for retiree dental (5/19/04 #5B)	TBD	
David	Verify Board's SPIF/STIF investment policy & develop if none (8/18/04 # 2) (1-6-05 #4)		
David	Provide soft dollar report (6/14/04 #6)		
David	Follow-up on Loomis redesign & FI proposal (11/17/04 #6)		
David	E-mail proxy report to Board (11/17/04 #7)		
Beth	Comprehensive/detailed plan expenses info (11/17/04 #8)		
Beth	Expense comparison Jim vs. Jeb (11/17/04 #8)		
David	Research STIFF/SPIFF sweet info w/ SSB (1-6-05 #4)		
David	Research SSB fees; index vs. active (1-6-05 #5)		
All	Review Bond & FI asset class (1-6-05 #7)		